Public Utilities

FORTNIGHTLY

Volume 53 No. 7 April 1, 1954

PRACTICALITIES IN RATE MAKING TODAY
By Justin R. Whiting

« »

Limiting FPC Control over Gas Distribution
By Oswald Maland and James Zartman

« »

Capital Cost and Fair Return
Part III.
By J. Rhoads Foster

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FEATURE SECTIONS

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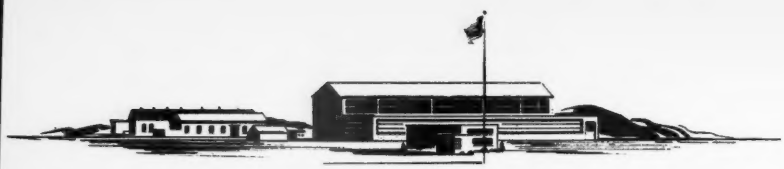


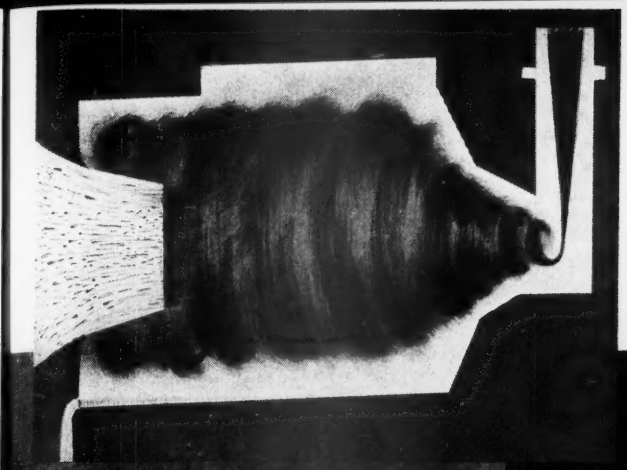
important advances in firing

Two important advances in firing—the Cyclo Furnace and Pressure Firing—used singly or combination, are bringing major savings to c tral station and industrial boiler users. The ception and wide acceptance given both of th B&W developments result from proved e ciency and economy . . . amply demonstra in the chart below.

The chart lists many possible ways in wh the Cyclone Furnace and Pressure Firing c tribute to better operation—often just o advantage means important economy. The re lutionary Cyclone Furnace and B&W's lo range experience with Pressure Firing are w worth serious consideration in your evaluati

We will be pleased to discuss these and oth practical developments of B&W Research a Engineering as they relate to your power g eration program and facilities. The Babcock Wilcox Company, Boiler Division, 161 E 42nd Street, New York 17, N. Y.

	EFFICIENCY	MAINTENANCE	AVAILABILITY	AUXILIARY POW
CYCLONE FURNACE	• Efficient use of low-grade coals. • Extremely low carbon loss. • Low excess air.	• Practically no ID fan erosion. • Eliminates pulverizer maintenance. • Low maintenance on burner and coal preparation equipment. • Reduces cost of labor for ash and dust handling.	• Reduces slagging and cleaning of convection surfaces.	• Eliminates pulverizers. • Less soot blowing req
PRESSURE FIRING	• Less stack loss . . . no air infiltration.	• Fewer controls to maintain. • No ID fan maintenance.	• Simplifies fan control.	• Less total fan power to lower volume, weight draft loss handled by FD



CYCLONE FURNACE

PRESSURE FIRING

INITIAL COST

Lower building and foundation costs.

Greatly reduced fly ash emission requires less dust handling equipment . . . smaller precipitators • Eliminates electrical connections and controls for PC motors • Smaller soot blower compressor.

Simplified design lowers duct and stack costs • ID fan can often be eliminated.

ACCEPTANCE

B&W's revolutionary method of firing is being used for boilers having steam capacities as high as 1,200,000 lb per hr., pressures to 2250 psi, and temperatures to 1050 F. Burning coal, oil, and gas. Total generating capacity of all Cyclone Furnace Boilers in service and on order is over 2,000,000 KW. Accumulated service-time on all units is nearly a half century.

Broad acceptance of B&W's pressurized-furnace design is shown by the units in service and on order—by 27 electric utilities and some industrial plants—to serve a total generating capacity exceeding 8,500,000 KW. They include Radiant, Open Pass, Integral-Furnace and Stirling Boilers with individual steam capacities ranging between 200,000 and 1,370,000 lb per hr., design pressures to 2700 psi, and temperatures to 1100 F.

BABCOCK & WILCOX

BOILER DIVISION

G-596

Pages with the Editors

EVER since the end of World War II until fairly recent months, public utility industries in the United States have been engaged in a battle of catching up with plant requirements and service demand. That battle is by no means won, in terms of safe margins of reserves and plant capacity, in all sections of the country. But at least the cessation of hostilities in Korea and other stabilizing factors have permitted the utilities to make tremendous strides in handling backlogs of accumulated service demand and plant construction.

THIS brings up a question of ultimate goals. What is the optimum objective of the gas, electric, and telephone businesses and of the carriers? As far as actual connection with central station service, the electric utilities have probably moved closer to fulfillment of all resonable demands for customer service. But we know that the potential demand for electric service is one of constant and dynamic growth.

THE swiftly growing natural gas industry is rapidly completing the job of reaching one of the last major untouched market areas—that of New England. And the Pacific Northwest is now under close study of rival pipeline applications before the Federal Power Commission.

JUSTIN R. WHITING

IN A recent issue of the *U. S. News & World Report,* an exclusive interview with Cleo F. Craig, president of the American Telephone and Telegraph Company, gave a stirring account of the goal of the telephone industry. It is one which is not even restricted by the boundaries of the United States. It is, in short, a world network. As Mr. Craig put it in a very informal way: "Bell and those very early pioneers of the telephone business had the dream, if you want to call it that, the concept, that this was an instrument that could be used to connect up anybody, anywhere — not only within the United States but in the world. And that concept, in my estimation, still lives just as strongly today in the telephone business as it did then, and it has been responsible all the way from, say, 1878, 1880, all through the development of the telephone business. That goal lives in the mind of each telephone man and woman. That's No. 1 as to why we've gotten from where we were to where we are."

FROM the nature of other utility services, the ultimate objective cannot be quite so extensive, at least in an international sense. But it is reassuring to see the other utility companies, as well as the telephone industry, considering and functioning in terms of potential rather than actual or immediate customer demand. Like the counsels of perfection, such goals may never be reached.

BUT progress toward these goals will be greatly assisted to the extent that teamwork within the various utility industries becomes an established fact. Doubtless, there is a phase in the growth of all industry where rivalry is a spur to rapid growth and resourceful enterprise. But the squabblings of the last two decades betweeen private and public ownership, between area interests and economic

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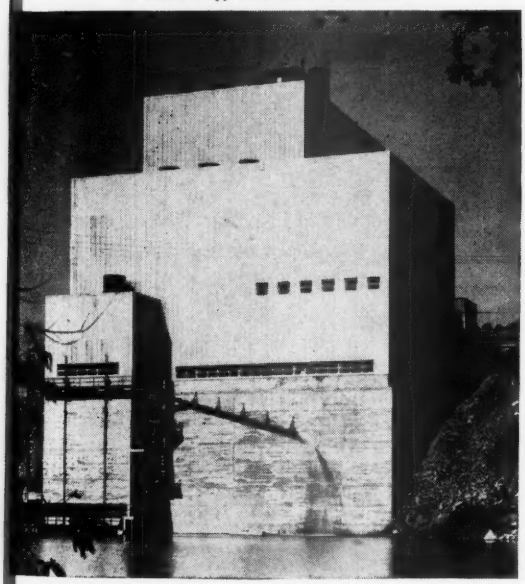

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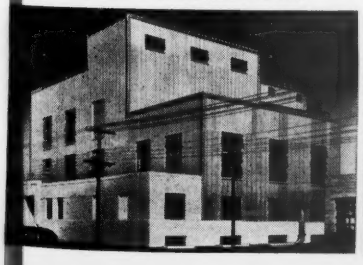
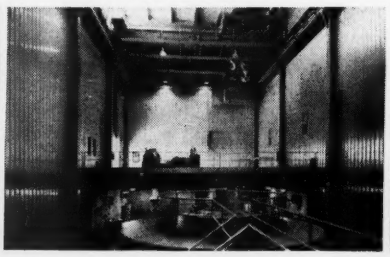


Tennessee Valley Authority Watauga Project Elizabethton, Tenn.



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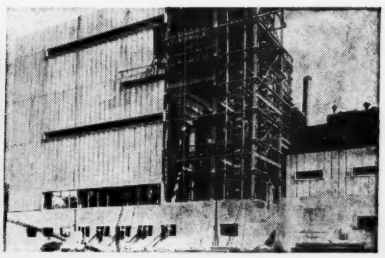


interests, can easily hinder the march of the utility industries toward ultimate goals.

IN the particular field of economic conflict, one of the stumbling blocks in resolving differences between the consumer and the investor has occasionally been a lack of consistency or downright fairness in the enforcement of regulatory principles. Readers may recall the serious suggestion once made by a distinguished United States Senator in commenting on the classical controversy between the reproduction cost rate base and the original cost rate base for fixing utility rates. To the Senator, the solution was quite simple. He thought the regulatory commissions should use *whichever base were lower.*

IN other words, during a period of declining prices when current cost of property might be less than original cost, the reproduction cost factor would be perfectly proper. But when (as is most often the case) the current cost to reproduce is in excess of original cost, the latter basis should be used. It is just such "heads I win, tails you lose" attitudes which confuse the issues in utility regulation and prevent the harmonious approach to what is at best a complicated and difficult problem in its own right.

THE leading article in this issue is a plea for honest adherence to sound principles for modern rate making, accepting the result in a spirit of fairness and consistency whether prices move up or down. This is an analysis of the rate-making situation as it has developed in up-to-date regulatory practice by the chairman of the board of Consumers Power Company, JUSTIN R. WHITING. Born in St. Clair, Michigan, MR. WHITING graduated from the university of that state (LLB, '07). He practiced law in Jackson and Detroit before going to New York city to become counsel for the former Commonwealth & Southern Corporation. He eventually became president and director of that holding company, succeeding the late Wendell L. Willkie in 1940. He took over his present post with the Consumers Power Company upon the separation of that company from the Commonwealth & Southern group under the Holding Company Act.

OSWALD MALAND

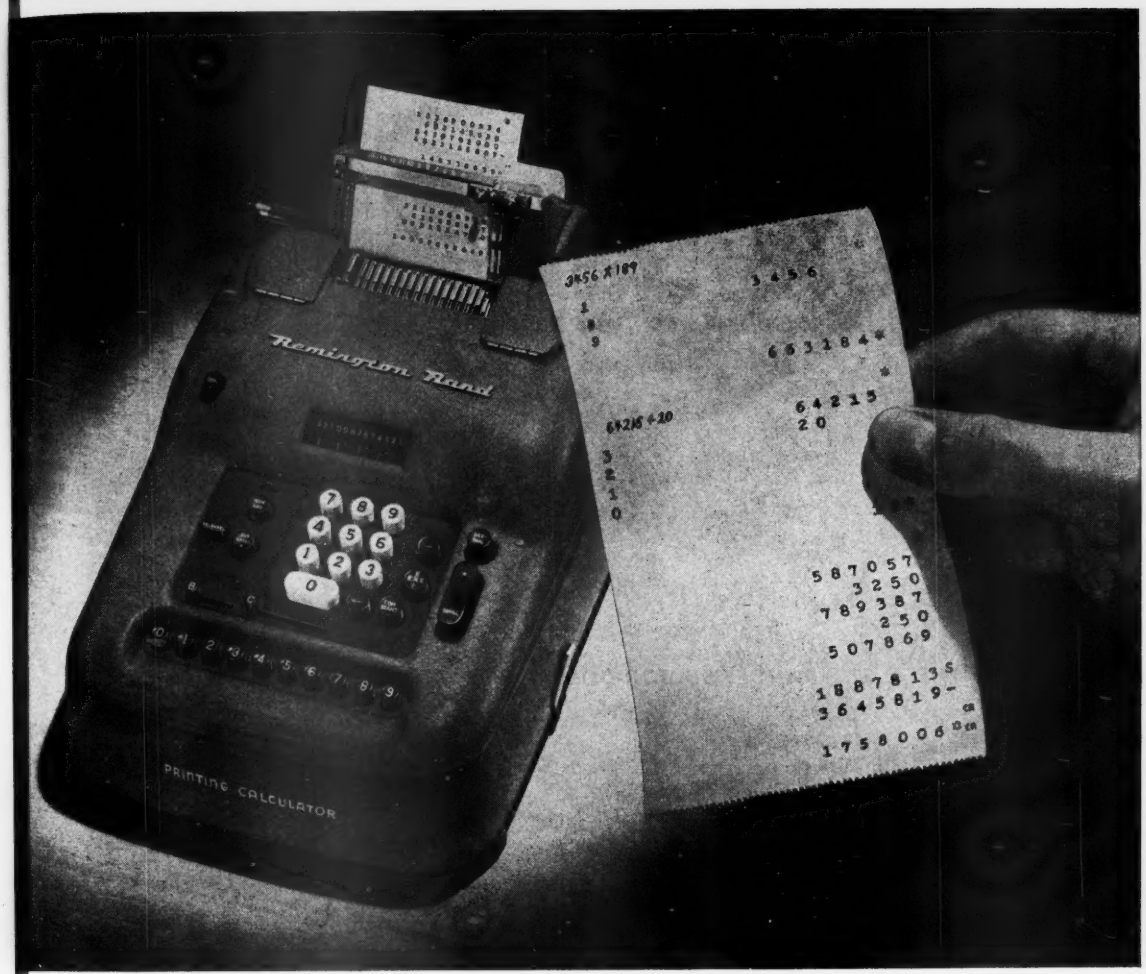
* * * *

CONGRESS has recently approved a proposal to limit Federal Power Commission jurisdiction over intrastate gas distribution. The basis of this proposal grows out of a sweeping decision of the U. S. Supreme Court in the East Ohio Gas Company Case, which has resulted in a certain amount of duplicate and overlapping federal and state jurisdiction. But there are other considerations which might well be weighed by Congress, according to these authors of the article beginning on page 413, OSWALD MALAND and JAMES ZARTMAN, Chicago attorneys.

OSWALD MALAND is a native of Minnesota and a graduate of the law college of the University of Minnesota ('15). He practiced law in Mason City, Iowa, before becoming associated with the Chicago firm of Chapman and Cutler, where he now specializes in the field of corporate securities. JAMES ZARTMAN is a graduate of the law college of Harvard University ('53), after receiving his academic education at De Pauw University.

THE next number of this magazine will out April 15th.

The Editors



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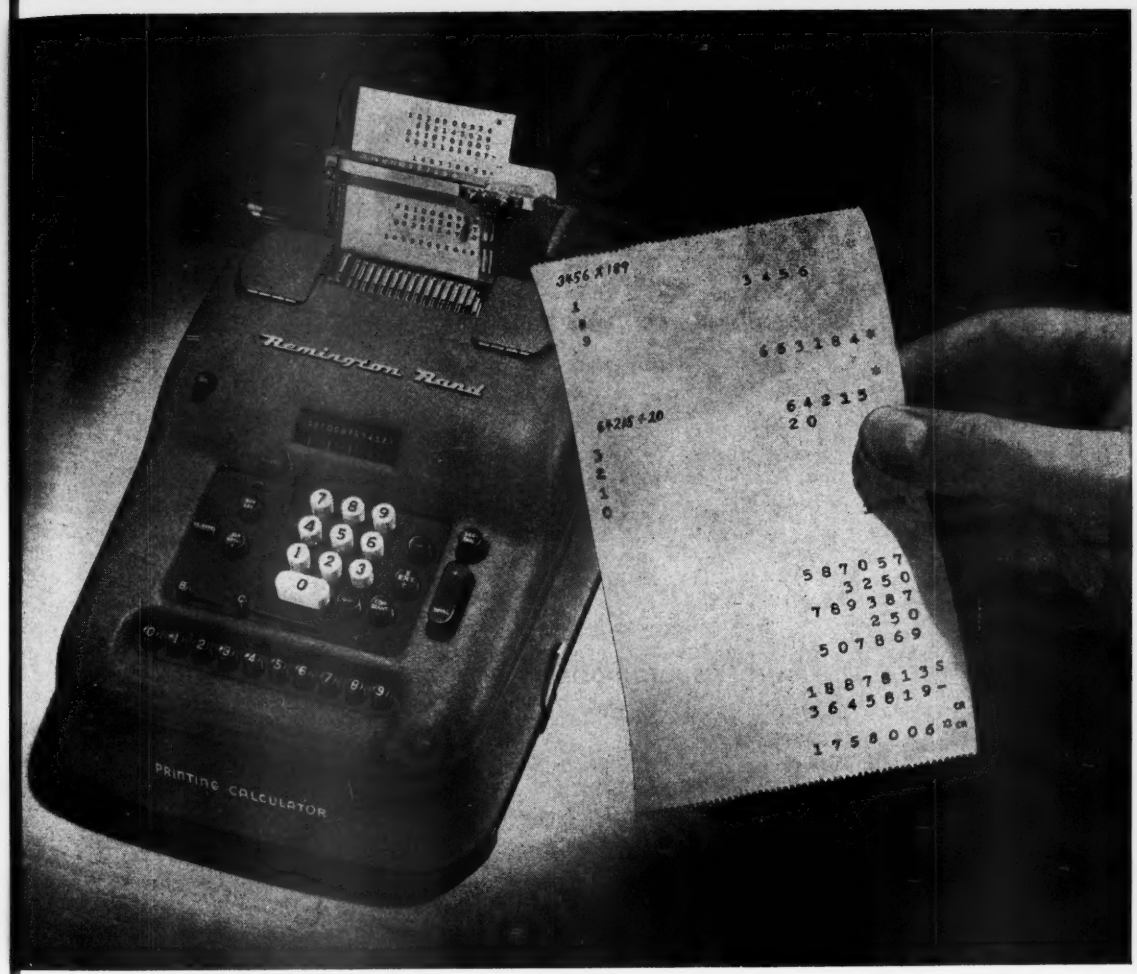

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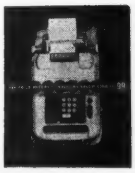

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Coming IN THE NEXT ISSUE

★

THE ADJUSTMENT CLAUSE, AN AID TO RATE REGULATION

Since the last prewar year of 1940, the cost of living has been doubled through a steadily rising price trend. But during that same period the cost of fuel oil used by some utilities has fluctuated greatly, reaching at times a level almost triple the prewar low price. Orrin S. Vogel, director of rates and research of the Florida Power Corporation, has made a study of such utility expense fluctuation and the use of various types of escalator clauses to adjust utility rates in accordance with the more radical expense variations. As a result, he has written an interesting account of the acceptance by the regulatory authorities of adjustment clauses. There are reasons given as to why the adjustment clause, properly constructed, operates as a positive aid in effective rate regulation.

HOW THE AT&T FINANCES BILLION-DOLLAR PROGRAMS

Since the end of World War II, the American Telephone and Telegraph Company has been engaged in a series of record-breaking security issues, forming part of a $10 billion program for financing plant to meet the unprecedented demand by the people of the United States for telephone service. The problem of distributing these tremendous issues has challenged all the "know-how" and resourcefulness of the Bell system experts. J. Louis Donnelly of the editorial staff of the New York **Journal of Commerce** describes the steps taken to cope with financial operations of this magnitude. He tells how and why they go off so smoothly that AT&T has been able to sell to its shareholders and investors more than $2.6 billion worth of convertible debentures during the postwar period. This is an article which will interest all financial men, as well as those connected with utility companies having large financial operations pending or in prospect.

NEW LIGHT ON AN OLD SUBJECT

Has the federal government actually discovered a way to make and serve electricity to the public cheaper or more efficiently than a privately owned utility? This is an old subject but it is approached in a new and objective way by David E. Goggin, rates and research assistant of the Wisconsin Public Service Corporation. The author gives facts and figures without the usual slant or argumentative outbursts about government competition with private business, etc. Readers will be interested to see the final figures for public and company power service after excluding taxes. Another point covered deals with expenses which are normally paid for utility service but may be covered up by absorption in municipal or other government operations, such as rental of office space, services of corporation counsel, and so forth.

★

Also . . . ***Special financial news, digests, and interpretations of court and commission decisions, general news happenings, reviews, Washington gossip, and other features of interest to public utility regulators, companies, executives, financial experts, employees, investors, and others.***

Remarkable Remarks

"There never was in the world two opinions alike."
—MONTAIGNE

DWIGHT D. EISENHOWER
President of the United States.

"Where people are concerned, be human, and where you deal with their money, their economy, their government, be conservative, and don't be afraid to use the word."

HARLOW H. CURTICE
President, General Motors Corporation.

"A planned economy has no place in my book, and I am sure none in yours. But the alternative to centralized planning by government is for private industry to take full advantage of its present opportunities."

FRANK CHODOROV
Associate editor, Human Events.

"Recognition of the fact that freedom is close to home led the founding fathers to put strict limits on the powers vested in the proposed central governments, and to place all unspecified powers in the hands of the state governments."

Excerpt from The Guaranty Survey, published by Guaranty Trust Company of New York.

"The 'positive program' that business needs from government today is not a program of new forms of intervention but a program for the restoration of the freedoms and incentives that spell true liberalism. Fortunately, our own government is moving in that direction."

GRAYSON KIRK
President, Columbia University.

"Future historians will have just cause to rejoice in the fact that at a critical time in the history of the world, the free enterprise system of the United States had the strength to safeguard the forces of freedom and democracy. Without this power, it is questionable if any of the free peoples could have protected their freedom."

M. S. RUKEYSER
Columnist.

"The mere chatter and ballyhoo of the huckstering spirit won't be enough, since the customer won't buy because of the fear of shortages or the depreciation of his money. He must be induced by improved production and better value. The coming year will reward those companies with the imagination and courage to take the leadership in product exploration, in order to make old models seem like undesirable 'old hat.' "

CRAWFORD H. GREENEWALT
President, E. I. du Pont de Nemours & Company, Inc.

"It is interesting to note that when anyone in the past has attempted to predict the long-term future, his forecast has turned out to be hopelessly shortsighted and pessimistic. The direction of our effort has changed over these two centuries of our national existence. Our frontiers have moved from the West into the research laboratory, and in that move have become frontiers without limit. Today it is research that gives the American economy its characteristic surge and its dynamic qualities. And research requires people with the same courage, vision, and determination as those who a century ago crossed the western plains."

International leads again...

INTERNATIONAL R-195 ROADLINER®
Famous Super Red Diamond engine. Gaso-
LPG, or diesel power. GCW rating, 48,000
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Better roads mean a better America

INTERNATIONAL® TRUCKS
"Standard of the Highway"

ARTHUR B. LANGLIE
Governor of Washington.

"I can see nothing in the future that could bring about a depression unless all of us—business, labor, government—fail in our job; unless we are gripped by an unreasoned fear psychosis."

BENJAMIN F. FAIRLESS
Chairman of the board, United States Steel Corporation.

"This is a time of great opportunity—opportunity for America to prove that it doesn't need war for prosperity —opportunity for us to prove that private enterprise, minus 'big government,' is the only formula for economic health."

PERRY M. SHOEMAKER
President, Lackawanna Railroad.

"We are on the threshold of the greatest opportunity the railroad industry has ever had, to re-evaluate its permament place in the fabric of American transportation. There is a place for all forms of transportation to serve the needs of industry."

JOHN R. DUNNING
Dean, Columbia University, School of Engineering.

"In a large sense, atomic energy is simply one of the striking symbols of man's long search for knowledge—knowledge of the world around him and knowledge of man himself. The progress of man is largely a matter of how we use this slowly won knowledge to build the kind of world we want. Knowledge by itself is neither good nor evil. The real question is how we use that knowledge which is the indispensable tool we must have to solve the world's problems."

CLIFFORD F. HOOD
President, United States Steel Corporation.

"In our form of government, public and private funds should not be commingled to finance an improvement project belonging unqualifiedly to the public and open, without discrimination, to all who respect the laws and regulations governing its use. That is a principle which, in this republic, should not be violated, no matter how attractive any proposition involving its violation might seem from the standpoint of either the public or the standpoint of a private interest."

EVERETT D. REESE
President, American Bankers Association.

"Sound money can be achieved only through the elimination of inflation. Gradually the federal budget must be brought into balance. Sound money cannot be assured until that is done, and a balanced budget in turn will require a willingness on the part of many segments of the population to stop seeking benefits for themselves from the federal government. Thus, our ability to maintain a sound dollar will hinge in large part on public opinion and public action. The American people must want and work for a sound dollar before it can be attained."

Excerpt from Industrial News Review.

"The head of a midwestern power company recently said something that should be read and remembered by all of us: 'Businessmen must stop acquiescing in government intervention which doesn't seem to directly concern them. They will have to quit taking a handout from Uncle Sam with one hand, while they take a poke at bureaucrats with the other.' That fits every group of citizens—including labor and agriculture as well as business people. The height of hypocrisy is to demand cheaper and more limited government as a general principle—and then to keep right on seeking special benefits for oneself."

Northwest Rivers Sing a Song of New Power

Late last summer, two new hydroelectric plants began generating power in the Northwest. Both demonstrate man's skill and ingenuity in harnessing the forces of Nature, and in each case the engineering and construction were handled by Ebasco.

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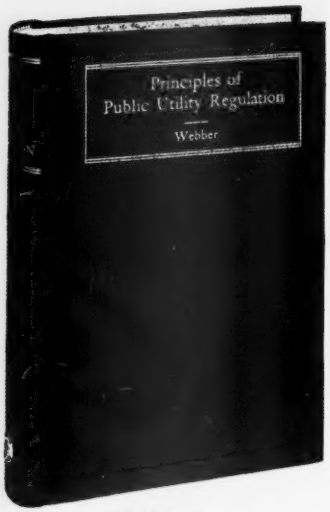
PRINCIPLES OF PUBLIC UTILITY REGULATION

(1941)



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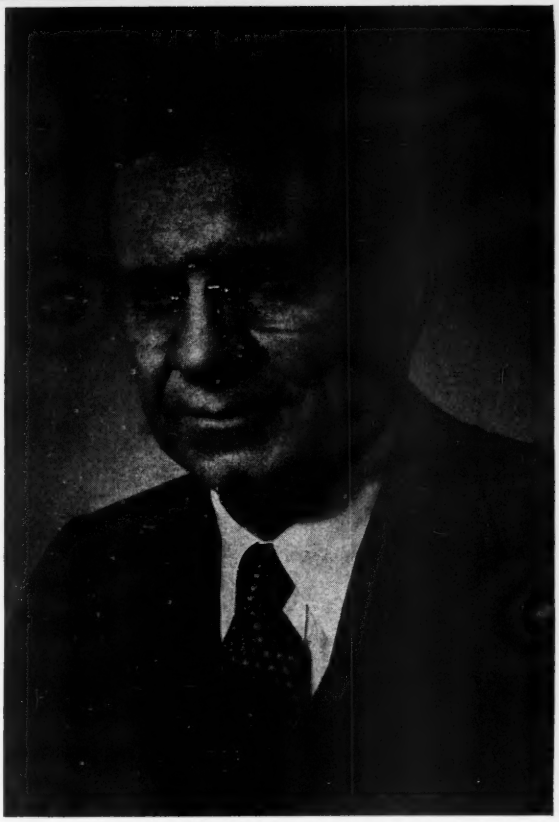

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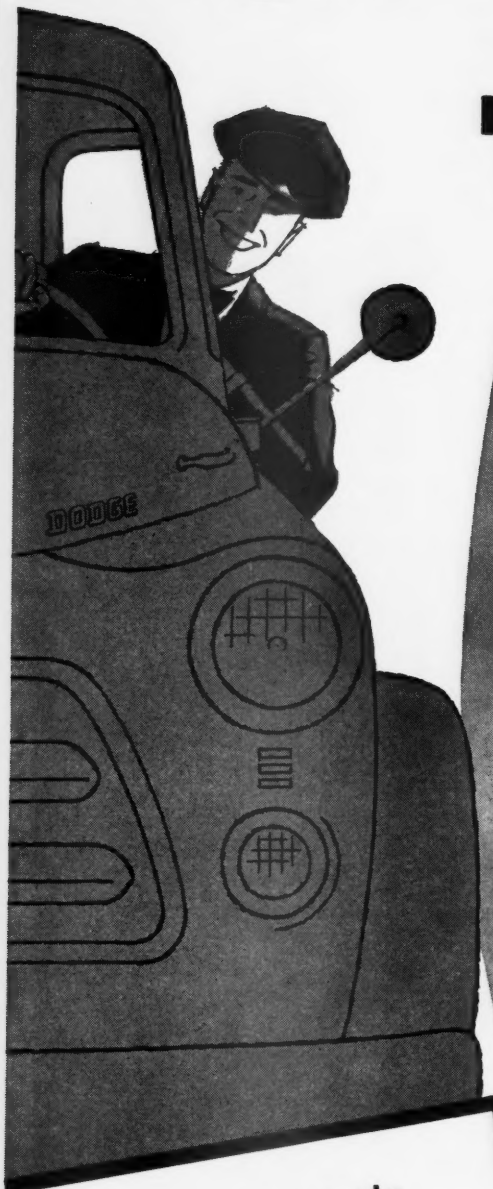

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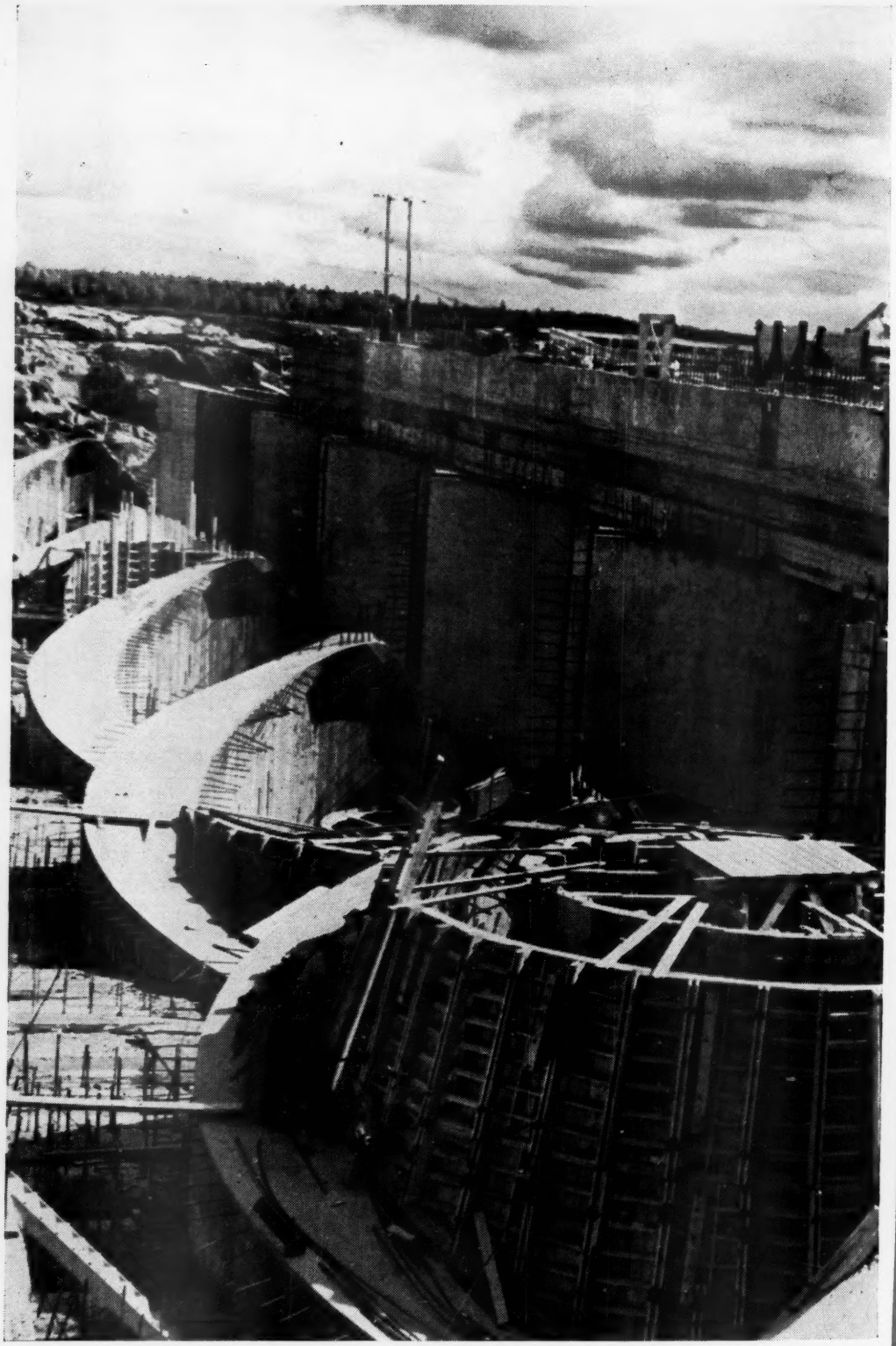
Thursday—1 *Electrical Maintenance Engineers Association of Southern California begins electrical industry show, Los Angeles, Cal.*	**Friday—2** *Northwest Public Power Association ends 3-day annual convention, Tacoma, Wash.*	**Saturday—3** *American Water Works Association, New York Section, will hold annual meeting, Watertown, N. Y. Apr. 22, 23. Advance notice.*	**Sunday—4** *American Public Relations Association begins meeting, New York, N. Y.*
Monday—5 *Edison Electric Institute begins annual sales conference, Chicago, Ill.*	**Tuesday—6** *Iowa Independent Telephone Association begins annual convention, Des Moines, Iowa.*	**Wednesday—7** *American Water Works Association, Kansas Section, begins annual meeting, Emporia, Kan.*	**Thursday—8** *Louisiana Polytechnic Institute begins annual instrumentation conference, Ruston, La.*
Friday—9 *Missouri Valley Electric Association ends 3-day engineering conference, Kansas City, Mo.*	**Saturday—10** *Indiana Gas Association will hold annual meeting, French Lick, Ind. Apr. 22, 23. Advance notice.*	**Sunday—11** *Illuminating Engineering Society begins southwestern regional conference, Houston, Tex.*	**Monday—12** *National Conference of Electric and Gas Utility Accountants begins, Boston, Mass.*
Tuesday—13 *Oklahoma Utilities Association begins southwestern gas measurement short course, Norman, Okla.*	**Wednesday—14** *American Gas Association ends 3-day sales conference on industrial and commercial gas, Chicago, Ill.*	**Thursday—15** *National Personnel Conference of the Gas Industry begins, Chicago, Ill.*	**Friday—16** *Illuminating Engineering Society ends 2-day intermountain regional conference, Denver, Colo.*



Hydro on the Winnipeg River

Neighbors to the north (Manitoba, Canada) are expecting the completion of the McArthur project in 1955, adding hydro capacity to Winnipeg Electric Company's controlled supply.

Public Utilities
FORTNIGHTLY

VOL. 53, NO. 7 APRIL 1, 1954

Practicalities in Rate Making Today

This is an analysis of the rate-making situation as it has developed in up-to-date regulatory practice. It contains a background and a summary which point to the basic problem of modern rate regulation—keeping abreast of cost changes.

BY JUSTIN R. WHITING*
CHAIRMAN OF THE BOARD, CONSUMERS POWER COMPANY

Economic Changes

PERIODICALLY since the advent of utility regulation in this country, we have experienced national economic changes or reverses. These readjustment periods are one of the factors of our capitalistic system. The foundations of a boom period are laid during the period of depression, and conversely the causes of a recession are bred during a boom. One of the indices by which these variations in trends may be followed is the change in the price of commodities.

These are days in which management is confronted with tremendous investment for future needs. All utility companies are trying to chart their course five years ahead of time. This has been brought about by reason of our expanding economy demanding more service and the develop-

*For additional personal note, see "Pages with the Editors."

ment of large high-temperature, high-pressure electro-steam generating units and other facilities. These installations involve long periods between the time of ordering from the manufacturer and the delivery. It, therefore, becomes increasingly important that the utility executive have some guide to aid him in charting our earning potential to pay for these facilities.

Discarded Gold Standard and Substituted Full Employment

We discarded the gold standard twenty years ago.[1] The purchasing power of the dollar as measured by consumer prices has declined during this period to 48 cents.[2] In spite of campaign promises, any administration which expects to keep in office is bound to undertake to maintain full employment. As a consequence, our economy will continue to expand and operating costs will continue to be high, as they have during this period. Disregarding minor short-term fluctuations, this will be the condition so long as these concepts of governmental fiscal policy obtain.

Rate-making Process Quasi Legal and Political

Rate proceedings before commissions are quasi legal. They follow the procedures of administrative law. Being a legislative function, they are also political in the better sense. By that is meant being "engaged in or connected with civil administration" as distinguished from being "more concerned to win favor or to retain power than to maintain principles."[3] If this civil administration is to be effective and arrive at fair results, it must proceed according to established principles as a guide. What are these principles?

How Can We Keep Abreast of Rising Costs?

How can we keep abreast of increased wages, taxes, and costs of materials in the operation of our utilities today? First, we must continue our traditional quest for operating economies. To mention only a few of these: mechanize where practical; install the most efficient facilities; seek to avoid overtime wages in the operation of the business; and try to give the best possible service for the customer's dollar.

After this we are bound to make our rates for service in accordance with the economics of the day. The guide by which we arrive at such end result has been wrought in the evolution of our rate making over the past seventy-five years.

Evolution of Rate Making

A summary review of this is enlightening:

1. *Arbitrary Regulation.* During the boom (1871) following the Civil War, an Illinois statute fixing the maximum charges on storage of grain was adopted. Numerous states adopted the Granger laws fixing maximum railroad charges. By the time the court proceedings testing the constitutionality of these laws reached their final stages, the depression of 1873 had set in. Many railroads were in receivership and these laws in many states had been repealed. In 1877, in Munn *v.* Illinois[4] it was decided that the grain

[1] U.S. Code Annotated, Title 31, par. 315b.

[2] Computed from Consumers' Price Index, The Economic Almanac, 1953-54.

[3] The American College Dictionary (Random House).

[4] 94 US 113.

elevator business was clothed with a public interest and that regulation by a state statute under the police power was constitutional. The Granger laws were likewise upheld.

So it was that we were launched upon a fixed and arbitrary regulation of utilities of that day.

2. *Legislative Power Delegated to Commission.* Nine years later in 1886 in Stone *v.* Farmers Loan & Trust Co.,[5] the court upheld the validity of a Mississippi statute providing for a railroad commission with full regulatory powers. It was provided that rates must be reasonable. For the first time the Supreme Court intimated that determination of the reasonableness of a rate might be subject to judicial review. Further, the court held that the power to regulate was not the power to destroy. The court said:

> Under pretense of regulating fares and freights, the state cannot require a railroad corporation to carry persons or property without reward; neither can it do that which in law amounts to a taking of private property for public use without just compensation, or without due process of law.

Here is the keystone of our regulation of utility rates. The right of the state to regulate is based on the general police power, but its exercise must be reasonable and avoid a taking of private property for public use without just compensation. These two fundamental propositions have not changed. The body of rate law and regulation as we know it today has had its growth from these beginnings.

3. *Determination of Reasonableness—Fair Value.* It was eight years later, during the depression of 1893 when property values had declined below original cost, that William Jennings Bryan sought a reduction in railroad rates based upon the then fair value of the railroads' property, in Smyth *v.* Ames.[6] In the course of the opinion it is stated:

> We hold, however, that the basis of all calculations as to the reasonableness of rates to be charged by a corporation maintaining a highway under legislative sanction must be the fair value of the property being used by it for the convenience of the public. And, in order to ascertain that value, the original cost of construction, the amount expended in permanent improvements, the amount and market value of its bonds and stock, the present as compared with the original cost of construction, the probable earning capacity of the property under

[5] 116 US 307.

[6] 169 US 466, 546.

¶ *"We discarded the gold standard twenty years ago. The purchasing power of the dollar as measured by consumer prices has declined during this period to 48 cents. In spite of campaign promises, any administration which expects to keep in office is bound to undertake to maintain full employment. As a consequence, our economy will continue to expand and operating costs will continue to be high, as they have during this period."*

particular rates prescribed by statute, and the sum required to meet operating expenses, are all matters for consideration, and are to be given such weight as may be just and right in each case. We do not say that there may not be other matters to be regarded in estimating the value of the property. What the company is entitled to ask is a fair return upon the value of that which it employs for the public convenience. On the other hand, what the public is entitled to demand is that no more be exacted from it for the use of a public highway than the services rendered by it are reasonably worth.

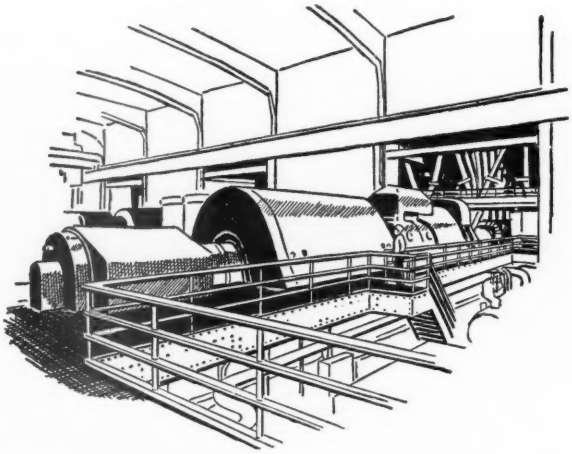
For the next forty-seven years, utility rate regulation in this country followed the standards laid down in these cases. Many states adopted statutes making mandatory the procedure by which reasonable rates should be determined. Among these generally was a provision that a fair value rate base be found and a reasonable rate of return allowed thereon. Many states established a similar rule of case law.

4. *Occurrences Contributing to Hope Case.* The economy throughout this long period was again affected by world events: the Spanish American War, World War I, and World War II. Our economy continued to expand. The utility industry has become our largest industry in point of investment. Market values of all property and securities during the boom of the twenties rose to unheard of heights. Speculation was rife. Then followed the great depression of 1929 and the thirties when values collapsed, businesses failed, men wanted to work and could not get jobs. The political philosophy of our federal government changed. The New Deal came into power in 1933. The pendulum swung the other way. A crusade ensued in a punitive atmosphere in which laws were enacted to right the wrongs of the past. The most basic change so far as our economy is concerned was the repeal of the gold standard, to which I have already referred.

The Securities Act of 1933 and the Securities Exchange Act of 1934 both regulated the issuance of securities and practices pertaining to their sale. All securities sold were on prospectuses giving all facts pertaining to an issuer. A purchaser who will take time to read these will know all there is to be known about a company.

The Federal Power Act gave jurisdiction to the Federal Power Commission over electric utilities engaged in interstate commerce, with authority to regulate interstate rates. The commission was authorized to and did promulgate a classification of accounts. This classification required electric utilities to place upon their books of account the original cost of the utilities' property (the cost to the person first devoting the property to public use) with the amounts carried on the books in excess of such cost to be classified in other accounts. Such other accounts were required to be written off against surplus or capital or to be amortized over a period of time. A similar classification of accounts was adopted by the Federal Communications Commission and state public service commissions generally.

UTILITY men felt that if they were compelled to reflect on the books of account of a company the original cost of property, it would lead to abandonment



Equalizing Benefits of Price Changes

"If the American farmer, wage earner, and unregulated businesses are entitled to the benefits of increased value of their products when such values increase because of the lesser value of our currency, then the utilities should have the same benefits, and when conditions are reversed, we in the utility business should experience the same consequences as they affect our industry. This is in the manner of our tradition."

of the fair value concept. This proposition was raised in the American Teleph. & Teleg. Co. *v.* United States.[7] In the course of the opinion, Justice Cardozo says:

> . . . To avoid the chance of misunderstanding and to give adequate assurance to the companies as to the practice to be followed, we requested the Assistant Attorney General to reduce his statements . . . to writing in behalf of the commission. He did this and informs us that "the Federal Communications Commission construes the provisions of . . . (the order)" as meaning "that amounts included in Account 100.4 (which is the same as Account 100.5 for the electric industry) that are deemed, after a fair consideration of all the circumstances, to represent an investment which the accounting company has made in assets of continuing value will be retained in that account until such assets cease to exist or are retired; . . ."
>
> We accept this declaration as an administrative construction binding upon the commission in its future dealings with the companies. . . . *The administrative construction now affixed to the contested order devitalizes the objection that difference between present*

[7] 299 US 232, 16 PUR NS 225, 231.

value and original cost is withdrawn from recognition as a legitimate investment. (Italics supplied.)

THIS so-called "administrative construction" has been honored in its breach by many regulatory authorities.

The Johnson Act[8] enacted in 1934 took away from utilities the right to engage in lengthy rate cases by filing suit in a United States trial court to enjoin the putting into effect of a commission rate order on the ground that it violated due process. We all know that the procedure now calls for an appeal direct from the order appealed from.

Under the Federal Power Act, the Federal Power Commission compelled all utilities engaged in interstate commerce to write off from their books large amounts carried in excess of original cost.

The Securities and Exchange Commission in the administration of the Public Utility Holding Company Act of 1935 caused most of the public utility holding companies to dissolve or reorganize.

It was in 1938 that the Natural Gas Act was adopted, giving the Federal Power Commission jurisdiction over interstate natural gas rates where no regulation had before existed. Congress admonished the Federal Power Commission to allow rates only slightly above a confiscatory rate by empowering the commission to order a ". . . decrease where existing rates are unjust, unlawful, or *are not the lowest reasonable rates.*" It was only asked to consider fair value when found "necessary for rate-making purposes."

5. *End Result by Experts.* The Hope Natural Gas Company was owned by the Standard Oil Company (New Jersey). It had been engaged in a prosperous business for thirty-five years—the sale of natural gas in interstate commerce. It plowed large sums from earnings back into the business and paid substantial cash dividends to its parent. In a proceeding before the Federal Power Commission to reduce its rates as provided by the Natural Gas Act, an order was entered on May 26, 1942. The commission found a rate base, applied a rate of return, and allowed certain rates. On statutory appeal to the Supreme Court in Federal Power Commission *v.* Hope Nat. Gas Co.,[9] the Supreme Court upheld the order on the principle that the total effect of the rate order could not be said to be unjust and unreasonable.

MR. JUSTICE DOUGLAS, speaking for the court, said:

> . . . From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. . . . By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital. . . .

He further said, referring to the order:

> . . . It is the product of expert judgment which carries a presumption of validity. . . .

[8] U.S. Code Annotated, Title 28, § 1342.

[9] 320 US 591, 51 PUR NS 193, 199, 200.

The Douglas opinion goes on to state:

> . . . But the fact that the value is reduced does not mean that the regulation is invalid. . . . It does, however, indicate that "fair value" is the end product of the process of rate making, not the starting point . . . The heart of the matter is that rates cannot be made to depend upon "fair value" when the value of the going enterprise depends on earnings under whatever rates may be anticipated.

FIVE opinions were rendered in this case. All parties interested have been in doubt as to the exact meaning or conclusions to be drawn from this decision. Ten years have elapsed since its rendition. Discussion and argument about its meaning still persist. It is not my purpose to enter into this discussion. Recent articles appearing in the October 8, pages 528 and 554, October 22, page 635, and December 3, 1953, page 817, of the PUBLIC UTILITIES FORTNIGHTLY deal with both the legal and philosophical aspects of this subject in a scholarly and comprehensive manner. It was on this decision under these circumstances that the word went out that our rate-making processes throughout the states had been changed. The Hope Case was thought to be the bible of rate making.

I will undertake to point out some other things which have happened since, and the practical aspects of rate regulation as it exists today in light of these four famous cases to which I have alluded.

Occurrences Since the Hope Case

SINCE the Hope Case, inflation resulting from military expenditures and foreign aid caused by World War II and Korea has persisted. As a consequence, utilities have been forced to seek increased rates to meet mounting costs.

Commissions and courts in many states have come to realize that the standards to be used in arriving at reasonable rates under the statutes of their states have not been changed. As previously mentioned, among these standards generally is a provision that a fair value rate base be found and a reasonable rate of return allowed thereon.

Unlike the Natural Gas Act, state commissions have been authorized and accustomed in fixing rates for the future to be given some leeway or a zone within which rates may be established. "Between the point where a rate may be said to be so low as to be confiscatory and the point where it must be said to be so high as to be oppressive upon the public, there is a 'twilight zone' within which the judgment of the commission may operate without judicial interference. . . ."[10]

[10] City of Detroit *v.* Michigan Railroad Commission, 209 Mich 395, at 433, PUR1920D 867, 901.

¶ "STATES *which laid down the orderly rate-making process as mandatory either by statute or case law have saved their public service commissions from an uncharted sea. Within the ambit of these statutes or rules of law lies a zone within which utility rates may readily be established. Utility rates are for the future. They are not susceptible of exact arithmetical calculation.*"

In City of Pittsburgh *v.* Pennsylvania Public Utility Commission,[11] the superior court of Pennsylvania held that the decision in the Hope Case did not change the law of Pennsylvania. The Pennsylvania commission has continued to use fair value as a rate base and has given substantial weight to reproduction cost evidence, with the approval of the courts of the state.

The Ohio commission has continued to determine value on the basis of reconstruction cost new less depreciation in accordance with the statute. This view was sustained in the City of Marietta *v.* Public Utilities Commission.[12]

IN the Consumers Power Company electric rate case [13] in January, 1950, the Michigan commission stated that it was high time that the matter of the proper approach to a rate base "should be decided and announced for once and for all." It first quoted from § 7 of Act 106 of the Public Acts of Michigan for 1909 (MSA 22.157) which provides:

> . . . In determining the proper price, the commission *shall* consider and give due weight to all lawful elements properly to be considered to enable it to determine the just and reasonable price to be fixed for supplying electricity, including cost, reasonable return on the fair value of all property used in the service, depreciation, obsolescence, risks of business, value of service to the consumer, the connected load, the hours of the day when used, and the quantity used each month . . . (Italics supplied.)

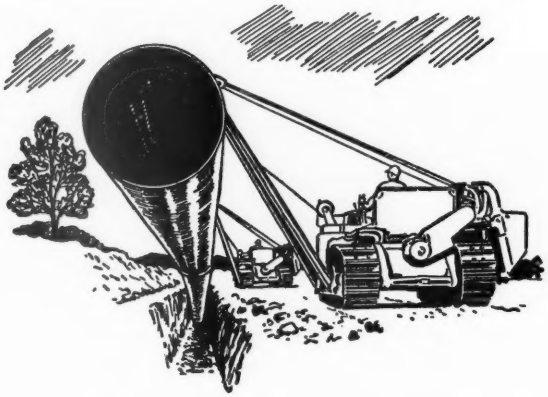
The commission then reviewed various decisions of the commission, the supreme court of Michigan, and the United States Supreme Court and concluded that ". . . both our legislature and our Supreme Court have told us that we are to operate upon the basis of fair value."

The commission made it clear that original cost is not the sole criterion of value. It said:

> As we see it, the determination of fair value is a matter of judgment. It is to be exercised by the commission after giving careful consideration to all the various elements entering into the formation of a sound, reasonable, and intelligent judgment as to the present fair value of the property of the utility used and useful in its business.
>
> We are considering this question at a time in the economic history of this country when we are experiencing the most violent inflationary period of our national life. The evidence shows that the facilities and property of this utility have been constructed and acquired over a period upwards of thirty-five years and it is incredible that fair value measured in 1949 dollars is not in excess of the original cost of construction or acquisition. If it is worth anything more than its original cost, it necessarily follows that in determining its present worth, we are departing from original cost as the sole criterion of value.

THE Maryland Court of Appeals in Chesapeake & P. Teleph. Co. *v.* Public Service Commission,[14] held that the commission was required to use a fair

[11] 61 PUR NS 226.
[12] 71 PUR NS 186.
[13] 82 PUR NS 97, 105, 108.
[14] 97 PUR NS 50.



No Snob Arguments on Rate Base Issue

"WHERE it is necessary to seek higher rates because of higher operating costs brought about by inflation, we must reject the view that it is old-fashioned to rely upon fair value as fundamental. The drudgery of proving fair value in a rate hearing is now pretty well dissipated. Utilities maintain continuing property records. Today's costs are readily applied to each item of plant. Commissions and their staffs are conversant with the state of efficiency of the properties of the utilities under their jurisdiction."

value rate base. Attempts subsequently made to amend the statute to provide for an original cost rate base have thus far been unsuccessful.

The Maine Supreme Judicial Court in New England Teleph. & Teleg. Co. *v.* Public Utilities Commission,[15] held that the rate base was present fair value and not original cost. The Maine statute was subsequently amended but still provides for a consideration of current value in fixing reasonable value of property.

The Marion County Circuit Court of Indiana in Indiana Bell Teleph. Co. *v.* Public Service Commission,[16] held that a utility was entitled to a reasonable return on the fair value of its property and that recognition should be given to reproduction cost in determining that value.

The Illinois Commerce Commission considered that it was not required to find a fair value rate base, but the Illinois Supreme Court in Illinois Bell Teleph. Co. *v.* Illinois Commerce Commission,[17] held that present fair value continues to be the basis for rate making in Illinois.

IN the report of the committee on valuation of the National Association of Railroad and Utilities Commissioners,

[15] 98 PUR NS 326.
[16] 93 PUR NS 480.
[17] 98 PUR NS 379.

made in September, 1953 (on page 6), it is stated:

> The Hope Case decision was taken by many commissions, both federal and state, as permitting the use of original cost as the rate base in place of fair value and many took the view that it was no longer necessary to allow rates which would produce the equivalent of a fair return on the fair value of the property. It should be borne in mind, however, that the court did not lift all constitutional restraint and that to date it has not adopted original cost as the rate base for the test of confiscation.
>
> Despite the holding in the Hope Case, some utilities in a great majority of states have continued to offer evidence of present value in postwar rate cases. The ground for offering such proof has been that it is the established law of the state, as distinguished from federal law, or that to achieve a just and reasonable end result requires the recognition of such evidence in fixing rates. This evidence has taken a variety of forms, including reproduction cost new and estimates of current cost based on trended original cost.

In those jurisdictions where a net original cost rate base is used today, the commissions invariably state that much of the property of the utility has been constructed since World War II and therefore current costs are reflected in original cost. This argument does not stand up under analysis. In the first place, a far smaller proportion of the property has been constructed since World War II than the number of dollars spent on construction would lead one to believe. In the second place, utility construction costs have not remained stable during this postwar period but have continued to climb to new heights each year and in the past four years have increased about 25 per cent. Most important of all, a grave injustice is done to prior investors by ignoring the change in the value of our currency since they made their investment.

Appraisal of Value in Market Place

Although our issuance and sale of securities are closely regulated, yet common stocks today are freely bought and sold at prices well above their original depreciated book value. Charles Tatham, Jr., of Institutional Utility Service, Inc., in an article published by the New York Society of Security Analysts and reprinted in the *Analysts Journal* of November, 1953, analyzes the average market price percentage of book value in AAA, AA, and A public utility common stocks over the years of 1943-52. He shows the average market price of the common stocks of all of these companies over these years to be 138 per cent of their book value. He quotes Commissioner Nelson Lee Smith of the Federal Power Commission in a talk given before the National Federation of Financial Analysts Societies in Philadelphia in April, 1953, as saying:

> I think we can agree that for equity financing to be attractive stock must command an appreciable premium over book value and that perhaps this premium must be greater in the newly established venture than the old and seasoned company. The question is, how great must this premium be?

He also refers to a statement made by James A. Lyles, vice president of

the First Boston Corporation, in an address before the New York Society of Security Analysts in September, 1952. Mr. Lyles said:

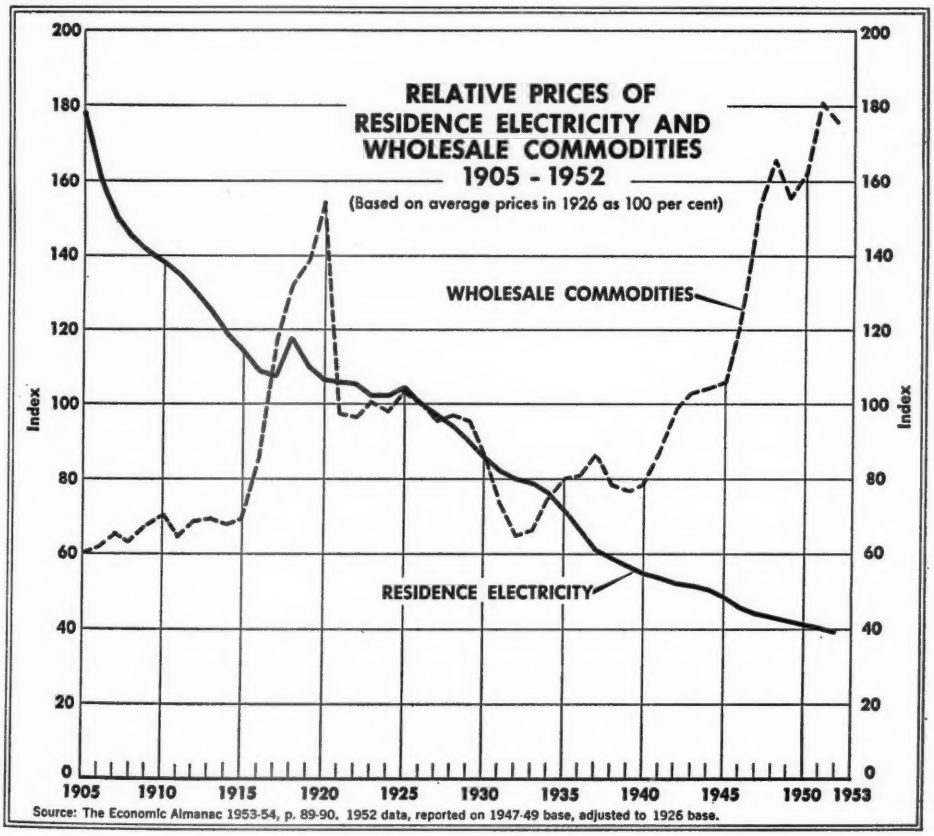
> . . . The meat of the coconut to me is simply that each individual company must be provided with enough dollars of earnings to enable it, in the light of its own cash requirements and particular circumstances, to continue to raise its common stock money at an appreciable premium over book value.

He refers to a recent letter from Dr. James A. Bonbright in which he stated as follows:

> I believe that regulation should encourage soundly managed companies to earn returns that will support a material excess in market values over book values during periods of prosperity.

MR. TATHAM concludes his article with this statement:

> In summing up it appears reasonable to conclude that for a company with a typical capitalization structure and a



growth rate approximating that of the industry, an average market price premium of about 40 per cent above book value is reasonable. If the growth rate is such as to require periodically substantial amounts of new equity capital, considerably higher premiums appear justified and may well be necessary in order to provide the incentive for new investment in the field.

Here is a recognition by willing purchasers and willing sellers in the market place of an underlying value in excess of the original cost depreciated. In some instances it may be a recognition of the requirements of the territory operated in causing substantial growth of utility plant. Again, it may be an appraisal of good management of the company, but to my mind it includes an innate reliance upon the fairness of commissions which authorized such original sales and our constitutional guaranty that the stockholders' interest in the fair value of the property will be protected against confiscatory rates. Our practices and development of the industry over this long period of time have had this guaranty in the background.

Electric Power and Light Industry A Young Industry

THE electric power and light industry is young. You will not find many of its rate cases adjudicated in the decisions of the United States Supreme Court. The rapid development in the art of generating and transmitting electricity, together with the tremendous expansion of the industry, resulted in reduced costs. As a consequence, while the trend of commodity prices in general was upward, there was an almost continuous decline in electric rates for half a century, as is shown by the chart appearing on page 409.

During all this period utility managements were accustomed only to reduce rates. The inflation resulting from the governmental policies adopted in 1932-36 was at first masked by the depression and then suppressed by wartime price controls. It was not until the effects of inflation were made manifest at the close of World War II that many utility managements were confronted with the necessity of seeking increased rates. Neither they nor their attorneys had been on the affirmative side of a rate proceeding. It is not strange that they were timid. They have sometimes temporized in the name of what passes for expediency. This failure stoutly to affirm their position has not sprung from any lack of conviction. Rather it has come about through discouragement with the refusal of some commissions to look the economic facts of life squarely in the face.

FOLLOWING this governmental fiscal policy, utilities were able to make great savings in interest costs by the refunding of their bonds. This factor has now been outrun by the continual increase in costs of construction and operation resulting from the depreciation of our dollar. The plain fact is utility earnings, the wages of their invested capital, have not kept pace with the general movement of the whole economy during the past decade.

Let's assume a concrete illustration: A hydro generation plant was constructed in 1914 when common labor earned two and one-half dollars a day and other costs were comparable. The plant has been well maintained except that the windings of its armatures today are better than the

Planning for Future Needs

***"THESE** are days in which management is confronted with tremendous investment for future needs. All utility companies are trying to chart their course five years ahead of time. This has been brought about by reason of our expanding economy demanding more service and the development of large high-temperature, high-pressure electro-steam generating units and other facilities. These installations involve long periods between the time of ordering from the manufacturer and the delivery."*

original. It generates as many kilowatt-hours in a given period of time as it did forty years ago. It is a vibrant part of an expanded, integrated electric system. In considering its worth in fixing rates in today's dollars should it be regarded as a relic of antiquity and have ascribed to it the cost of forty years ago less depreciation?

Such an approach, it seems to me, disregards what has happened in the interval and is unfair to the investors whose dollars made the facility available.

We Must Face Up to the Economics Of the Day

WHERE it is necessary to seek higher rates because of higher operating costs brought about by inflation, we must reject the view that it is old-fashioned to rely upon fair value as fundamental. The drudgery of proving fair value in a rate hearing is now pretty well dissipated. Utilities maintain continuing property records. Today's costs are readily applied to each item of plant. Commissions and their staffs are conversant with the state

of efficiency of the properties of the utilities under their jurisdiction. No longer is the case transferred into a federal court where it must be tried all over again in a hostile atmosphere of antagonists. Today when the utility is the moving party the usual practice is for it to prepare its exhibits and either submit them to the commission staff in advance, or else submit them in evidence, afford the staff opportunity to examine them and cross-examine in regard to them, and to submit evidence in reply at an adjourned hearing. The modern rate hearing takes on more the character of a proceeding where all the parties have mutual respect for one another and seek to arrive at a fair result.

If our rate proceedings are political in the better sense, they must "maintain principles" as a guide. To discard "fair value" as the starting point in the rate-making process and accept in its place the "end result" because it cannot be said to be unreasonable or unjust, confounds principle and makes the administrative process a proceeding subservient to preconceived ideas of men and not according to principle or standard. An investor might as well say that two of the main risks of the utility business are the caliber of its management and the fairness of its regulation.

STATES which laid down the orderly rate-making process as mandatory either by statute or case law have saved their public service commissions from an uncharted sea. Within the ambit of these statutes or rules of law lies a zone within which utility rates may readily be established. Utility rates are for the future. They are not susceptible of exact arithmetical calculation.

The determination of present-day fair value is out of the strict field of accountancy. It calls for the exercise of sound judgment. Utility management should face up to the economics of the day and provide commissions with all available proof to show the impact of the present economic forces in the operation of their company. So long as we live under the profit system, the profit derived will control in the fixing of fair rates and sound financing.

WE are often admonished by the original cost advocates that, if fair value is adopted, we will suffer when the cycle changes and values go into decline. My answer to this threat is that, to the extent this prediction may be true, we must assume the burden. In fact, that is one of the attributes of our American system. If the American farmer, wage earner, and unregulated businesses are entitled to the benefits of increased value of their products when such values increase because of the lesser value of our currency, then the utilities should have the same benefits, and when conditions are reversed, we in the utility business should experience the same consequences as they affect our industry. This is in the manner of our tradition. In the process, we gain economic muscle with which we can assist if necessary when called upon to preserve this very system which has made us strong as a nation.

Limiting FPC Control over Gas Distribution

Congress has recently passed a bill, growing out of a Supreme Court decision, to limit Federal Power Commission jurisdiction over intrastate gas distribution. This article suggests that intrastate activities might be exempt, regardless of whether a state commission exercises jurisdiction or whether state law provides for the same.

By OSWALD MALAND and JAMES ZARTMAN*

Out of the welter of conflicting opinion as to the form and manner of regulation of the natural gas industry, one proposition at least seems to have enlisted the support of all parties concerned, the industry, state and federal regulatory authorities, the courts, and the Congress: The proper balance has not yet been struck between federal, state, and local regulation. A number of bills and amendments thereto have been introduced in Congress in the past several years designed to correct this situation. Congress recently passed the Hinshaw Bill, which exempts from Federal Power Commission jurisdiction regulated intrastate gas distribution.

That such clarification is deemed vital, immediately, is evidenced by the fact that from the time of its introduction, the Hinshaw Bill, as proposed in the 83rd Congress, received the firm support of the state

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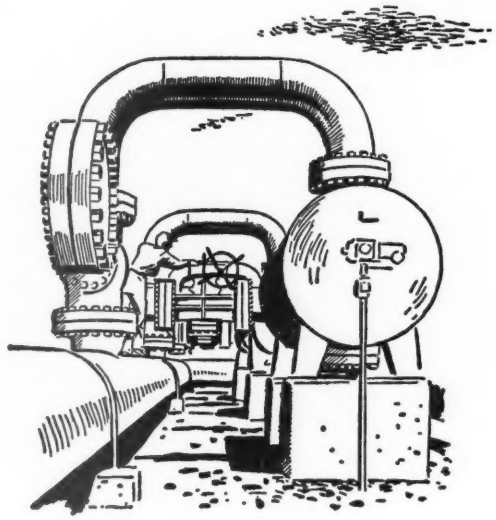

regulatory authorities, the Federal Power Commission itself, and the major portion of the industry. Time ran out on this bill before it could be brought to a vote in the Senate during the last session. Because the present session is still one of the 83rd Congress, the bill had retained the position as a pending bill when the session opened in January. The Senate completed congressional action on March 15th. Nevertheless, these writers would like to direct attention to certain inadequacies of the Hinshaw Bill, which might well warrant even further amendment.

THE pressure of activity to amend the Natural Gas Act was, of course, a result of widespread concern over the assertion by the FPC of jurisdiction over spheres of activity of the gas industry which seem to be matters of purely local concern, over activity which is being and can best be regulated locally. This assertion of an expanding jurisdiction has been sustained by the courts as valid as far as the *power* of the FPC is concerned. The Supreme Court, in the now famous case of Federal Power Commission *v.* East Ohio Gas Co. et al. (1950) 338 US 464, 82 PUR NS 1, held that the FPC has the power (as a matter of construction of the Constitution and the Natural Gas Act) to regulate the local distributor who operates completely within a single state if such distributor also operates pipelines by means of which he takes his gas at high pressure from the big interstate lines for local distribution. Federal regulation is sustained even though the gas is received and totally consumed within the state. The Natural Gas Act has been interpreted by the FPC to give it jurisdiction over local gas distributors who connect a distribution system with an interstate pipeline by means of a short stub line.[1] The line of demarcation between centralized and localized authority is drawn at the point where the pressure in the lines is reduced in order to supply the gas at the burner tips of the individual consumers.

THAT the delineation of the federal jurisdiction on the basis of this "peculiarly mechanistic formula" has created an anomalous and undesirable situation can admit of little doubt. A basic premise of our federal system is that regulation in this area by the centralized authority is permissible only where substantial interstate commerce is concerned, the considerations involved being those both of power and of policy.

Policy considerations would seem to dictate that centralized regulation of the local distributor is unwise: First of all, it must be kept in mind that the purpose of governmental regulation of utilities is to substitute, in the public interest, for the economic forces at work in a freely competitive industry. The market conditions with which the local distributor must contend are not national in scope, they are local problems varying the country over, differing in competitive factors for each area of local distribution. And since the problems with respect to the local distributor are not uniform, it is not in point to argue for the exercise of federal authority in order to achieve uniformity and simplicity of regulation. Regulation on a local basis will be better informed, more conversant with, and responsive to changing local conditions.

In the second place no legitimate inter-

[1] See article in January 5, 1950, issue of PUBLIC UTILITIES FORTNIGHTLY, page 13 *et seq.*, and in issue of October 26, 1950, page 603 *et seq.*

est is served by an overlapping and duplication of federal and local regulation. The end result is inefficient control, an industry unnecessarily burdened and uncertain as to its responsibilities, and, ultimately, loss and cost to the public as taxpayer and gas consumer. Where regulation of local distribution can be handled effectively by the local authorities, the imposition of federal power is both unnecessary and irrational.

Finally, as pointed out by Justice Jackson in his dissenting opinion in the East Ohio Gas Case, where there is a real conflict between state and federal authority, "experience shows state control will wither away and leave the federal rule in possession of the field." This "overriding of the state's authority" is not consonant with the purpose and intent of Congress in enacting the Natural Gas Act. "The key to an understanding of the federal Natural Gas Act is its purpose to supplement but not to supplant state regulation." The gap in the regulatory scheme which Congress intended and purported to fill by means of the Natural Gas Act was "in the wholesale realm of the natural gas industry in interstate commerce." Local distribution was an activity specifically excluded from the regulatory powers of the FPC.

THE above three reasons would seem to require that the jurisdiction of the FPC be clarified to meet the objections to the presently existing scheme of regulation. To this end the Hinshaw amendment was introduced. This bill exempts from federal regulation a company (and its facilities) which receives, within the state border, gas which is to be consumed in the state if "the rates and service of such person and facilities be subject to regulation by a state commission." Three types of intrastate dealers seem to be comprehended: (1) the retailer who takes title in-state, the gas to be delivered directly to the consumer; (2) the wholesaler who takes title in-state for resale within the state, the gas ultimately to be consumed within the state; (3) the dealer picking up gas in-state and transporting it for hire within the state for a wholesaler or retailer, all of such gas to be consumed in-state.

But these dealers are exempt only if they and their facilities "be subject to regulation by a state commission." This proviso is coupled with the stipulation that "a certification from such state commission . . . that (it) has regulatory jurisdiction over rates and services of such (dealers) and facilities and is exercising such jurisdiction shall constitute conclusive evidence of such regulatory power or jurisdiction." These two clauses together seem clearly to mean that where there is no state commission (which, as hereinafter explained, includes the regulatory body of a

¶ "THE *Hinshaw Bill is designed to correct the lack of balance of power between federal and local authority created by the East Ohio Case and the decisions of the FPC. It is designed to preserve local regulation where the local authorities can regulate and are regulating most effectively, to prevent an overlapping of functions and powers, and to insure that local regulation is supplemented rather than supplanted.*"

municipality) with jurisdiction over rates, services, and facilities, there will be no exemption. Even the retailer delivering directly to the consumer (by means of a stub line connection with an interstate pipeline) and handling gas only within the state, on a local basis, would still be subject to the regulatory power of the FPC if the necessity had not arisen in that state to constitute a commission with the authority to regulate the rates, services, and facilities of that dealer. (It is hereinafter pointed out that a municipality never has jurisdiction over all of such matters.) In this situation, the local distributor, not coming within the exemption of the Hinshaw Bill as drawn and still subject to the ruling of the Supreme Court in the East Ohio Gas Company Case and the decisions of the FPC, would have no choice but to submit to the authority of the FPC.

THE problem is a real one. Five states have not extended the jurisdiction of their public utility commissions over the activities of companies engaged in the local distribution of natural gas. Minnesota, Mississippi, Nebraska, South Dakota, and Iowa have not seen fit to permit their commissions to regulate the intrastate natural gas industry (although the Nebraska commission regulates the issuance of securities by such industry).[2] It seems apparent that the local distributors in these states who maintain stub line connections with interstate lines will still be subject to the jurisdiction of the FPC under the Hinshaw amendment as finally approved by the 83rd Congress.

Further, the Hinshaw Bill provides that not only must the rates and services of the dealer be subject to regulation by a state commission but the *facilities* used by such dealer for the transportation or sale of the gas must be so subject as well before the exemption will apply. "Regulation of facilities" undoubtedly has reference to the regulation of construction and of service extensions, the control over facilities exercised through the issuance of certificates of public convenience and necessity or similar licenses or permits. If the stub line dealer must be subject to the jurisdiction of a state commission as to the issuance of certificates of public convenience and necessity for the exemption of the Hinshaw Bill to apply, not only will the dealers in the five states mentioned above remain subject to the power of the FPC but dealers in many other states (whose commissions have no authority to issue such permits) may not come within the exemptions provisions.

IN Colorado, where the services are to be rendered to a home-rule city, no certificate of public convenience is granted by the state commission. Franchises are granted only by the state general assembly in Connecticut. The cities themselves are the only bodies with power to grant gas franchises in Florida. In Indiana a new area may be served without authority from the commission. The operation, construction, and maintenance of municipal pipelines are subject to local regulation only in Iowa. The state commission of Louisiana cannot grant or withhold any gas franchise. Such Louisiana franchises are granted only by the municipalities or by the parish police juries. Maine utilities are chartered by acts of the legislature with authority, issued by the cities, to use the streets.

[2] *Moody's Public Utilities*, 1953 Manual, pp. a 134 —a 135.

Amending the Natural Gas Act

"To draw an amendment to the Natural Gas Act which perpetuates duplication of and unnecessary regulation in the retail distribution area, the most localized sphere of the gas industry's activities, is to fail to correct the very condition which gives rise to the necessity for the amendment. There is no more magic in the 'state commission' formula than there is in the 'point of reduction of pressure' formula."

THE authority for gas operations in Massachusetts is, in general, vested in the local aldermen or selectmen. In Minnesota, Mississippi, and Nebraska the cities regulate gas rates and franchises. Ohio gas franchises are granted by the municipalities alone; no other authority is required. In Oregon a certificate of public convenience and necessity is needed only in the case of projected gas operations in towns of populations of 2,000 or less. The South Carolina commission has authority to grant certificates of public convenience and necessity only for electric utilities; all gas franchises are granted by the towns. No commission of South Dakota has authority to regulate gas construction and facilities in the state. In Texas certificates from the state authorities are not required for gas operations. And in Washington certificates are granted by the towns, counties, or the highway commission. No special public service commission authority is required.[3]

THE term "state commission" is defined in the Natural Gas Act to mean the regulatory body of the state or municipality having jurisdiction to regulate rates and charges for the sale of natural gas to consumers within the state or municipality. (See Natural Gas Act, § 2 (8).) In view of this definition the exemption from FPC jurisdiction permitted by the Hinshaw Bill would exist in the event it could be established that the regulatory body of a municipality has jurisdiction over the "rates, services, and facilities" of the party op-

[3] The above information has been compiled by Moody's from the answers to questionnaires sent out to the various state commissions. This compilation is to be found at pp. a 135—a 136 of *Moody's Public Utilities*, 1953 Manual.

erating the gas transportation pipeline. We know of no statute which gives to the regulatory body of a municipality power to issue or refuse to issue certificates of public convenience and necessity for, or to take other action of a similar character with respect to, pipelines located outside the corporate limits. Therefore, the fact that the term "state commission" includes a regulatory body of a municipality creates no basis for an exemption under the proposed Hinshaw Bill.

THE Hinshaw Bill is designed to correct the lack of balance of power between federal and local authority created by the East Ohio Case and the decisions of the FPC. It is designed to preserve local regulation where the local authorities can regulate and are regulating most effectively, to prevent an overlapping of functions and powers, and to insure that local regulation is supplemented rather than supplanted.

The amendment as passed does not do these things, at least as far as the intrastate *retail* distributor is concerned.

The exemption of the bill is extended to three types of in-state dealers or handlers: the retailer, the wholesaler, and the person transporting for hire. Of these three types, one, the retailer, is generally subject to the regulation of and being regulated by the public authorities within the local distribution area. Whether or not a formally constituted commission of the state is in the picture, affirmatively exercising jurisdiction over the retailer, that retailer is regulated as to franchises by the municipal or county authorities and as to rates by either the state commission or the municipality where distribution is made (although the facilities used in the transportation of gas situated outside the corporate limits are not so regulated).

Even though the retailer has now been held to be subject to the jurisdiction of the FPC because of the ownership of lines connecting local distribution facilities with high-pressure lines located in the same state as such facilities, under the Natural Gas Act the FPC has no control over such retailer with respect to rates charged by the retailer in local distribution or over his local distribution facilities. (See § 1(b) of the Natural Gas Act.)

THE extension of FPC jurisdiction over the activities of this intrastate retailer is neither wise nor necessary in the public interest. One objection to the jurisdiction of the FPC under these circumstances is that in view of the lack of control of the federal commission over the local distribution facilities and local rates and the regulation of such matters locally there should be no occasion to require the retailer to go to the FPC as a condition precedent to the construction of any pipeline located within a state connecting the local distribution facilities with a high-pressure interstate pipeline. Certificates of convenience and necessity are designed to protect against the construction of lines where the field is already occupied and to avoid the construction of unnecessary lines.

In the case of a local gas distributor the question of competition is controlled by the local municipality, since no one can effect distribution of gas in a municipality unless he secures a local franchise or other similar right. The question of whether or not the construction of the line is necessary is also controlled in a similar manner by the local municipality.

An additional and important objection to the jurisdiction of the FPC in this situation is the fact that by virtue of the ownership of a stub or connecting line the accounting of the retailer becomes unnecessarily subject to the control of the federal authorities and the retailer is required to comply with the accounting regulations of the FPC and to file all required reports.

To draw an amendment to the Natural Gas Act which perpetuates duplication of and unnecessary regulation in the retail distribution area, the most localized sphere of the gas industry's activities, is to fail to correct the very condition which gives rise to the necessity for the amendment. There is no more magic in the "state commission" formula than there is in the "point of reduction of pressure" formula.

The case is different as to the intrastate wholesaler serving the public and the person transporting for hire. In the cases where regulation of these persons is necessary in the public interest, if the state commission does not have jurisdiction to regulate and the FPC is denied this power, a very real gap would be created in the regulatory scheme.

The municipalities cannot and do not regulate the wholesaler serving the public effectively; and although proper amendment of the Gas Act would eliminate duplication of regulation, it should not create any hiatus in the pattern of that regulation. To the extent that the activities of the intrastate wholesaler serving the public and dealer transporting for hire should be controlled by public authority and to the extent that the FPC has the power under the East Ohio Gas Company decision to regulate the intrastate activity of these persons, it would seem that authority should be vested in either a state commission or in the FPC to impose regulatory measures upon this portion of the industry.

To meet the foregoing objections and to accomplish the purposes for which it was intended, a further amendment to the Hinshaw Bill would have to exempt the in-state retailer (although he maintains connections between the local distribution facilities and an interstate pipeline) from FPC jurisdiction regardless of whether a formal commission of the state is exercising jurisdiction over him and his facilities. Whether or not the exemption should be held to apply to the in-state wholesaler or to the in-state company transporting for hire (unless a state commission is controlling their activities), it is submitted that the local distributor selling at retail should not in any event be subjected to the regulatory power of the FPC.

A revision of the Hinshaw Bill which would have this effect by requiring the certificate of the state commission only in case the facilities are those of an interstate

¶ "THE *line of demarcation between centralized and localized authority is drawn at the point where the pressure in the lines is reduced in order to supply the gas at the burner tips of the individual consumers. That the delineation of the federal jurisdiction on the basis of this 'peculiarly mechanistic formula' has created an anomalous and undesirable situation can admit of little doubt.*"

wholesaler or a person transporting for hire is set out below. The new matter proposed is italicized:

(c) The provisions of this act shall not apply to any person engaged in or legally authorized to engage in the transportation in interstate commerce or the sale in interstate commerce for resale, of natural gas received by such person from another person within or at the boundary of a state if all the natural gas so received is ultimately consumed within such state, or to any facilities used by such person for such transportation or sale, provided, *if the facilities used by any person are used or are to be used for or in connection with the sale of natural gas in interstate commerce for resale or for or in connection with the transportation of natural gas in interstate commerce for hire it shall appear* that the rates and service of such person . . . *are* subject to regulation by a state commission. The matters exempted from the provisions of this act by this subsection are hereby declared to be matters primarily of local concern and subject to regulation by the several states. A certification from such state commission to the Federal Power Commission that such state commission has regulatory jurisdiction over rates and service of such person . . . and is exercising such jurisdiction shall constitute conclusive evidence of such regulatory power or jurisdiction.

THE deletion of the words "and facilities" in the proposed amendment has been suggested in case it is deemed advisable to extend the exemption from FPC jurisdiction to the in-state wholesaler and to the person transporting for hire in those cases where a state commission has a jurisdiction to regulate these dealers which does not include the power to issue certificates of public convenience and necessity to them or to otherwise regulate the construction and extension of their facilities.

If such further change is not adopted so as to eliminate the requirement of state commission jurisdiction of the character now provided in the Hinshaw Bill in cases not involving the in-state wholesaler and the person transporting gas for hire, then an amendment to the Natural Gas Act should be adopted which would eliminate accounting jurisdiction of the FPC over persons who are not engaged in the wholesale sale of gas or transportation for hire of natural gas. The fact that a person engaged in local distribution also happens to have a line located entirely within the state which connects the local distribution facilities with a high-pressure interstate line is not a logical basis for vesting in the FPC jurisdiction over the accounting of such person.

Higher Peaks Ahead

"JUST as only a few years ago no one would have forecast the height of the business peak in 1953, no one can forecast with any assurance the peaks in the years ahead except that we will see still higher ones in the future."

—STANLEY C. HOPE,
President, Esso Standard Oil Company.

Capital Cost and Fair Return

PART III. *The Past versus Future Prospects in Testing Reasonable Allowance*

The rather extended analysis and review of the guiding principles (Part I and Part II) provide the basis for identifying the capital cost concept which has validity and meaning for the purpose of utility rate regulation in the present circumstance. The term "competitive cost of capital" was used to describe this kind of capital cost. In this instalment the author suggests some more specific definitions of capital cost and stresses the importance of considering future prospects as well as past test periods.

BY J. RHOADS FOSTER*

COST of capital to any given public utility changes with the passage of time, depending upon changes in the general level of interest rates, in the characteristics and circumstances influencing market appraisals of investment risk, and of opportunities to realize capital gains.

A first question is thus presented:

Is a capital cost rate for the purpose of fair rate of return determination properly the cost on the basis of which the existing capital was committed to the enterprise from time to time?

Or is it the cost on the basis of which the existing capital could be replaced, or new capital obtained in reasonable amounts, at the time of the proceeding?

THE answer to this question depends largely on whether or not the value of money has remained reasonably stable. The prudent investment doctrine of rate regulation, as originally conceived (Brandeis), had a consistent regard for the conditions under which capital was committed to the regulated enterprise. It would use the invested capital as the rate base, but would allow a rate of return corresponding to the costs of such capital un-

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der the conditions existing at the time of investment (experienced cost of debt, preferred and common stock capital), not the cost as at the time of the rate proceeding (current cost).

If the general price level were reasonably stable, or if price changes were mere fluctuations (so that prices could be expected to return to their starting levels within reasonable time limits), the prudent investment method could be made to provide reasonable results.

However, the decline in the value of money has now gone so far and is prospectively so permanent that a consistent use of the prudent investment method will not provide returns that are economically adequate or fair. The original cost formula is unfair and uneconomical for reasons that have been spelled out at some length. Thus, competitive cost is now the only available standard upon which the regulatory process may fix reasonable rates. This approach should have a consistent regard for the conditions existing at the time of the rate proceeding, with respect to both amount of capital (rate base) and rate of return (cost of capital).

When there has been a significant change in the value of money since the dates of investment in the enterprise, cost of capital committed from time to time in the past (and available to the company at the time of the proceeding) can be measured only in dollars of a constant or comparable purchasing power. This means the current value of the dollar, in which the return is necessarily realized. Therefore, assuming a rate base consistent with the competitive cost principle (the establishment of which is not dependent upon cost of reproduction evidence), it is a consistently determined competitive capital cost rate that is the valid and appropriate evidence of a fair rate of return.

Is a current cost of capital, consistent with the competitive cost standard, properly the cost of refinancing or replacement capital?

Or is it the cost of new and additional capital?

The financial history of an enterprise generally provides a more reliable indication of prospective earning capacity for funds already invested than for additional capital. When new capital is not yet employed, no earnings record is available, and a considerable lag may be experienced before a full earning power is reached. Therefore, as the general rule, investors require a larger return as compensation for the greater uncertainty. The cost per dollar of new capital, particularly in the case of common stock capital, is generally higher than the cost of replacement capital.

In the competitive world, the prospective returns required to induce construction of additional plant capacity, or to induce another competitor to enter a given field, must be at least equal to the current cost of the required additional capital. Corresponding returns are earned by the already existing productive facilities of equivalent capacity, assuming equal managerial efficiency. Therefore, it is the current cost of substantial increments of debt, preferred stock and common stock capital which is the relevant evidence of a fair rate of return to a public utility.

Does a current cost include costs of redeeming securities, or of eliminating or revising past contracts with investors for the purpose of giving the company ac-

cess to lower capital costs or more favorable terms?

The answer is that costs of this kind are related to past circumstances and have no place in a determination of currently competitive cost per dollar of capital.

The "imbedded costs" are not a part of the cost of inducing an additional supply of capital to a given competitive arena. They are not costs incurred by a new competitor seeking to enter the arena.

Is the investors' return requirement as a component of cost of capital, to be used as evidence of a fair rate of return, properly measured by whatever may be the prices at which already outstanding securities are traded in small lots?

Or, is it measured by the prices at which a substantially increased supply of the securities would be absorbed by the market?

Securities, whether bonds or stocks, offered in any substantial quantity tend to sell at lower prices (and therefore on the basis of larger return requirements) than do already outstanding securities having an equal claim on income and subject to equal investment risk. An offer of additional securities in substantial quantity makes a drain on the limited supply of capital available for investment at a given time. This is particularly true of common stock as compared with securities that are taken in large part by institutional investors. The stock must be priced sufficiently below the levels indicated by small-lot trading in the outstanding stock of the same or similar quality that the offer will be attractive to a sufficiently large number of investors and the additional supply will be absorbed.

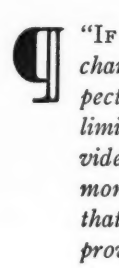
Since the market pressure is unavoidable, the effect is properly recognized in estimating the cost of new or additional capital to be used as evidence of a fair rate of return.

Should cost of capital for the purpose of fair rate of return determination be the cost on the basis of whatever may be the existing capital structure of the enterprise?

Or, should it be the estimated cost on the basis of some other and hypothetical structure?

The cost of debt, of preferred stock, and of common stock capital for any given public utility *each* varies with the capital structure. That is, the cost rates vary with the proportions of the different kinds of capital in the capitalization.

The financial management of an enterprise uses different kinds of securities to appeal to different investors, who are unlike in their ability and willingness to take risks. The total risk of the business is thus



"If *the general price level were reasonably stable, or if price changes were mere fluctuations (so that prices could be expected to return to their starting levels within reasonable time limits), the prudent investment method could be made to provide reasonable results. However, the decline in the value of money has now gone so far and is prospectively so permanent that a consistent use of the prudent investment method will not provide returns that are economically adequate or fair.*"

distributed unequally among the several classes of investors. The creditor requires a contract that protects him against a substantial proportion of the risks of the business, so that the risk burden falls disproportionately upon the owners. The bondholder is satisfied with a prospective return of, say, 3.5 per cent because the owners of the property have assumed a large share of the risk inherent in the employment of the capital represented by the bonds.

Obviously, the greater the amount of debt in relation to total capital, the greater the risk burden per dollar of common stock capital.

THE essence of the position of the common stockholders is that they receive as a return only whatever may be the balance of revenue remaining after all other requirements have been met, including operating expenses, taxes, depreciation, interest, and preferred dividends.

The greater the amount of debt and smaller the ratio of common stock to total capital, the greater the leverage and, other factors being equal, the higher the cost of common stock capital on an investment basis.

Conversely, where the amount of debt is relatively small, the risks shifted to the common stock are smaller per dollar of common stock capital.

The diagram on page 427 shows these relationships at a fairly recent date for electric utilities of approximately average investment quality. The data are not intended to represent any given utility. The cost of debt capital increases from about 3.4 per cent for a debt ratio (debt to total capital on a book basis) of only 10 per cent to about 3.7 per cent for a debt ratio of 50 per cent. Assuming that the preferred stock capital is in addition to debt amounting to 50 per cent of the total, the cost rate increases from 4.6 per cent to 5 per cent for a debt and preferred stock ratio of 75 per cent. The cost of common stock capital is here measured by reference to average market valuations of electric utility common stocks over the five years, 1948 to 1952, inclusive. The estimated cost is about 6.4 per cent, assuming no debt or preferred stock capital. The cost of common stock capital increases to about 8 per cent for a capital structure in which one-half of the capital is represented by common stock and to about 13 per cent for a common stock equity ratio of only 25 per cent.

UNDER "normal" market conditions, cost per dollar of total capital does not vary widely within a considerable range of differences in capital structure. For the composite electric utility, under the conditions reflected by the diagram, the cost rate varies from 6.1 per cent for a capital structure including 75 per cent common stock to 5.8 per cent for an equity ratio of 50 per cent and to about 6.1 per cent for an equity ratio of 30 per cent.

In theory, the cost per dollar of total capital does not vary with capital structure, because the total of business risk present in the enterprise is not changed by the manner in which that risk is distributed among the several classes of investors. In practice, the cost does vary somewhat with capital structure, for the reasons that the form of capitalization may introduce an element of investment risk, investors' comparative preferences for risk taking and for security change from time to time, and contracts with investors lag in their adjustment to the changes.

Adjusting the Inflexible Rate Base

"ACTUALLY, a fair return is incapable of rational determination unless and until it is recognized that the dollar is not a constant unit of measurement and the extent of the change in its purchasing power since the dates of investment is measured and known. Where the rate base is made inflexible, as a matter of administrative policy, the relevant changes in economic circumstances must be reflected in the allowable rate of return if the end result is to be fair and reasonable."

A GROSS kind of error of measurement is made when cost rates that are related to a given capital structure are used to estimate the capital cost which would be associated with some other capital structure. To illustrate, assume that the existing capital structure of a given company includes 30 per cent debt, for which the cost is 3.6 per cent, and 70 per cent common stock, for which the cost is 7.1 per cent. The computation would be made: $.30 \times 3.6\% + .70 \times 7.1\% = 6.05\%$. A regulatory commission might say: "The cost of capital is much lower on the debt portion than on the common stock portion; therefore we will determine the cost of capital on the basis of a capital structure including 45 per cent debt." The illustrative computation would be: $.45 \times 3.6\% + .55 \times 7.1\% = 5.5\%$. But the correct answer is closer to 6 per cent than 5.5 per cent. When the debt ratio is increased, other factors being unchanged, the cost rates for debt and of stock capital are each higher. The margins of protection available to each are reduced.

Neither are the proportions of debt and stock that provide the minimum capital cost, and the maximum market value of the investments, under spot or current market conditions, appropriately to be used for the purpose of fair rate of return determination.

Reference to the diagram suggests that, for the average electric utility under fairly recent market conditions, the "least cost"

combination includes from 40 to 50 per cent common stock capital. But the capital structure that results in the minimum capital cost and the maximum investment value is continuously shifting with market conditions. Several years ago, when the level of interest rates was depressed and the cost of common stock capital was higher than more recently, the capital structure providing the lowest cost per dollar of total capital included a relatively high proportion of debt and a much smaller proportion of common stock. That relationship, together with the tax discrimination against equity capital, caused some regulatory commissions to place pressure on public utilities to increase debt ratios.

THE charges for utility service should not be made to depend upon whatever may be the existing capital structure of the utility. The actual choice of capital structure for the corporate entity is a matter for financial management and should be viewed as a managerial responsibility. Rate regulation should allow scope for the exercise of that responsibility. The capital cost estimate is readily made on the basis of the capital structure which is prudent and reasonable in the light of the risk characteristics of the enterprise and relatively long-term market conditions. This is the policy that is consistent with the competitive cost standard. The actual capital structure of the given company is often within the range of reasonableness and would be used for this reason. Variations in capital structure, over a considerable range, make little difference in the capital cost estimate, assuming the estimate to be properly made. On the other hand, the capital cost associated with an abnormal capital structure, not prudent or reasonable in the light of the risk characteristics of the business and generally accepted financial standards, is not acceptable as the measure of a fair rate of return.

IS *the cost rate for common stock capital, as a component of the cost of capital, properly measured on the basis of whatever may be the stock market conditions at the time of the proceeding?*

Or, is it measured on the basis of more representative or "normal" conditions?

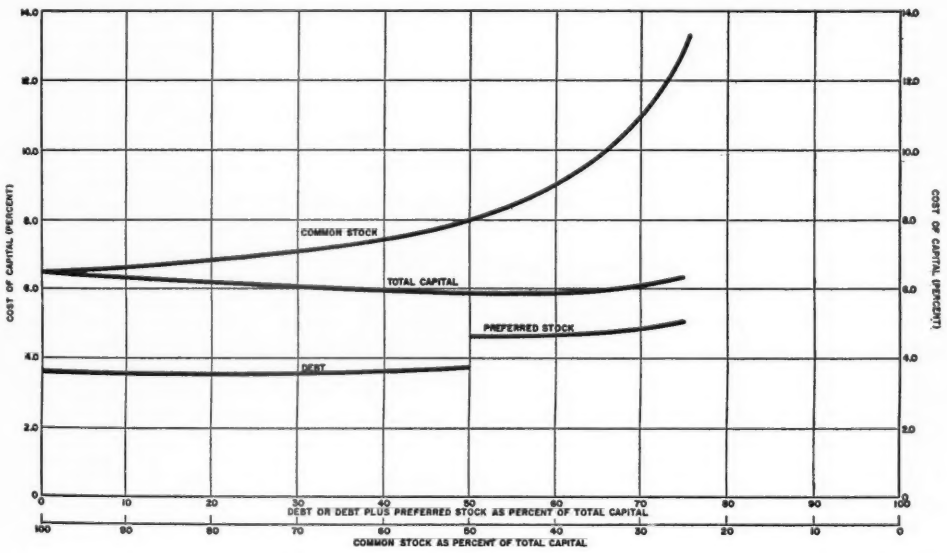
This question points to one of the limitations of the capital cost standard, for the purpose of rate regulation, even if capital cost be defined in economic terms. The stock market is influenced by recurring moods of optimism and pessimism, so that the price behavior is volatile and erratic. The swing may be from a bear market associated with business recession and uncertainty to a bull market associated with business confidence and activity. Cost per dollar of capital tends to be lower in periods of business confidence and prosperity and higher during periods of reduced business confidence. Therefore, a cost-of-capital estimate that reflects spot or short-term market conditions is unsatisfactory evidence of a fair rate of return. The allowable rate of return to a public utility should not be tied to the mood of the stock market. If influenced by the volatile movement of stock market prices, the rate of return is likely to be lower during periods of business prosperity and higher during periods of recession or depression. That kind of regulation would be economic folly.

But it cannot be expected that such a method of measurement will be applied consistently, so that the spot indications of capital cost will be reflected in rates of re-

turn when they are on the high side in a period of business depression. The history of rate regulation makes it clear that higher rates of return will not be allowed in periods of depressed business. Instead, the use of cost of capital as evidence of a fair rate of return would become a one-way street.

IF cost of common stock capital is to have any validity and usefulness for the purpose of fair rate of return determination, it must be defined as a representative or "normal" cost over a period long enough to eliminate the influence of cyclical changes and short-term fluctuations in the stock market. That kind of capital cost, appropriate for the purpose, may be called a "current cost" to distinguish it from the historically experienced cost of capital to the utility, but it is likely to vary significantly from a cost on the basis of spot market conditions.

A related aspect is the unreliable market appraisal of common stock leverage. Substantial prices are paid under certain market conditions for short-term and effervescent advantages of leverage. The common stock equities of natural gas transmission companies provide an illustration. During recent years, the market has capitalized the earnings on thin equities, narrowed to 20 per cent or an even smaller percentage of total capital (current balance sheet), on roughly the same basis as it capitalizes the earnings on broad equities of gas pipeline companies. The result is an apparently low cost per dollar of total capital for companies with high debt ratios and thin equities, but such common stock prices reflect speculative and short-term or even irrational appraisals, as distinguished from long-term investment appraisals. The risks of the pipeline business are not, in fact, reduced by increasing the amount of debt capital from, say, 40 to 80 per cent of total book capital. A policy of rate regulation which substantially reduces



the allowable rate of return because the debt ratio is 80 instead of 40 per cent is wholly irrational.

If the current appraisals of leverage position are to be made the basis of a lower rate of return, society should be prepared to allow the higher rates of return that would be required in periods of business adversity to reflect what will then appear to be the corresponding disadvantages of leverage position. Otherwise, use of cost of capital as evidence would become in this respect a one-way street.

Is cost of common stock capital properly measured by use of earnings-price ratios?

The earnings-price ratio is merely an arithmetic ratio between two independently determined facts or components; namely, (a) earnings per share as reported for a past accounting period (or periods), and (b) a spot or relatively short-term market price of the common stock. For example, an earnings-price ratio may be the computed relationship of annual earnings per share to the average of the twelve monthly high-low market values of the stock for the given year. Or, a monthly earnings-price ratio may be the computed relationship of latest reported earnings per share to the average high-low market value of the stock for each given month.

The ratio of reported earnings to market price is only by chance a measure of the rate at which investors are capitalizing prospective earnings, and thus of the cost of common stock capital.

It is elemental and generally understood by regulatory authorities, analysts, and economists that the cost of capital on an investment basis is measured by the rate at which investors capitalize what they believe to be the prospective returns from investment in the enterprise, plus the margin of cost incurred or to be incurred by the company in obtaining access to the capital supply.

UNFORTUNATELY, earnings-price ratios are all too often used as though they are in fact capitalization rates, without scrutiny or analysis to determine their meaning and significance. Any procedure that uses earnings-price ratios as part of a cost-of-capital formula without regard to their nature or meaning is indefensible.

The meaning of earnings-price ratios may be limited and their usefulness as evidence of cost of common stock capital impaired, in greater or lesser degree, by a wide variety of circumstances.

Each of the two components of the earnings-price ratio must have an exclusive relation to the other and each must be representative for the purpose, if the earnings-price ratio is to be valid and useful as evidence of cost per dollar of common stock capital.

Earnings per share as reported for a past accounting period (calculated on the basis of the end of period or an averaged number of shares) are not *as such* a measure of expected future earnings, for which the given price is paid in the market. Past earnings do not reflect whatever may be the anticipated changes in levels of operating expense, income or other taxes, in the demands for service, or any other factor influencing prospective, as distinguished from past, earnings. Earnings as reported may be very substantially distorted by nonrecurring items of revenue, operating expense, or taxes. Obviously, the reported earnings of a public utility engaged in a proceeding as to the reasonableness of its

A Rule of Reason for Rate Fixing

"A REASONABLE *rate structure is not something to be delicately balanced, as on the edge of a knife. Regulatory determinations ought to be made within the limits of a sensible zone of reasonableness, as an exercise of business judgment in the light of the relevant and guiding standards. And methods may readily be developed to reach these ends without the use of estimates of cost of reproduction less depreciation.*"

rates cannot be taken as the earnings expected by investors for the future. It is the latter that are reflected in the market appraisals.

THE price of a common stock reflects all the factors that influence the market appraisals, particularly all the prospective net advantages to be derived from ownership of the stock.

What are these net advantages? Prospective earnings and dividends are not the only advantages that may be available from ownership of common stocks. The market prices frequently reflect investors' expectations of capital gains or losses. Under some market conditions the dominant influences on price reflect speculative as distinguished from investment motivation.

The difficulties of using earnings-price ratios as evidence of cost of capital (also of other problems of regulation) are compounded when only a part of the total corporate business is within the jurisdiction of the regulatory authority.

For example, the jurisdiction of the Federal Power Commission over the gas pipeline companies extends to interstate transportation of gas and sales for resale in interstate commerce, but not to "production" and "gathering" or sales of gas to ultimate users.[1] Where a pipeline company owns production facilities and gas reserves, the value of those assets is reflected in the market price of the stock regardless of whether or not the assets are currently productive of income.

THE tremendous demand for the relatively underpriced natural gas provided incentives for the pressure, in one form or another, by the states that control the bulk of the gas reserves, to conserve the supply by increasing the prices at which gas might be taken relative to the prices of competitive fuels. The market prices of the stocks of companies owning gas reserves came to reflect the expectations of investors that sooner or later ownership interests in such reserves would have values of ownership interests in other and competing natural resources.

[1] Natural Gas Act, § 1(b); Re Phillips Petroleum Co. (FPC 1951) 90 PUR NS 325. Upon appeal in the Phillips Case, the court of appeals for the District of Columbia reversed the commission and held that the exemption of "production or gathering" does not extend to the interstate sales of gas by the company that produced or gathered it. (1953) 100 PUR NS 506. This decision is being appealed to the Supreme Court.

But the annual returns realizable by the pipeline companies on these assets have been thus far limited to relatively nominal amounts by use of accounting cost formulae.

In this situation, the market price does not have an exclusive relation to the income from the operations subject to regulation. Where the production facilities are not currently yielding income to the corporation, the earnings-price ratios understate the cost of capital to the regulated business by the proportion that the market price of the stock is accounted for by the mere ownership of the production facilities or gas reserves.

MANY other illustrations of the invalidity of earnings-price ratios for the purpose are readily available. The rate-making entity is the public utility or regulated business, not the corporation as such. Corporations supplying more than one kind of utility service having different risk characteristics or serving in more than one state comprise more than one public utility subject to fair return determination. The cost of capital to a combination company is generally not the same as what would be the cost to each of the parts, if they were separately capitalized. On the other hand, the cost to the corporate entity is not likely to be the sum of the cost to each of its several parts.

Still another complication arises because of the relation between dividend yield and earnings-price ratio. This relation corresponds, of course, to the proportion of earnings paid out as dividends. Assume two electric utilities, each with a 10 per cent earnings-price ratio on the basis of reported earnings and average market prices. Company A paid out 50 per cent and Company B 80 per cent of earnings as dividends:

	Company A	*Company B*
Market price	$100	$100
Earnings-price ratio ..	10%	10%
Dividend yield	5.0%	8.0%

Although the earnings-price ratios are the same, it is not correct to assume that investment risk and cost of capital are the same as between the two situations. The proportion of earnings paid out and prospectively to be paid out as dividends has a significant effect on the market price of the common stock and therefore on the percentage ratio of earnings (and dividends) to market price. Under the stock market conditions of recent years and for electric utilities generally, a dollar of retained income is valued by investors at a fraction of the value of a dollar of dividends. This ratio may be taken as one-third for the purpose of illustration. In other words, a bird in hand is worth three in the bush.

ON this basis, what would be the earnings-price ratios and dividend yields if *Company A* were paying out *80 per cent* and *Company B 50 per cent* of earnings as dividends? (See table, page 431.)

The adjusted earnings-price ratios and dividend yields indicate that investors' return requirement is 30 per cent higher in the case of Company B than in the case of Company A. The cost of capital is not the same between the two situations, although the unadjusted earnings-price ratios are identical.

This analysis, of course, assumes for the common stocks of both Company A and Company B that the earnings realized and the dividends paid during the given accounting period are representative for the future. Actually, the dividend pay-out

ratio as at a given time is a wholly inadequate indication of dividend policy or of prospective dividends. In the case of Company A, the dividend pay-out ratio might have been 50 per cent because of a nonrecurring bulge of earnings during the given accounting period, so that the market price actually reflects anticipated lesser earnings per share and a higher dividend pay-out ratio. In the case of Company B, the contrary might be the fact.

Cost of Capital and Fair Return

SOME may say that these refinements of concept and definition make the measurement of cost of capital too complex for practical application.

But the alternatives available in rate regulation are determined by commission policy and practice.

Some commissions fix rates calculated to provide an allowable revenue measured by "cost of service" for a test period. In rate increase proceedings, the items of operating expense, depreciation, and return, as components of "cost of service," are generally scrutinized closely and in detail, with the burden of proof as to reasonableness placed on the company.

In the circumstances of these proceedings, the facts are inherently complex and the procedural difficulties are enormous. The required volume of evidence places a heavy burden on already overburdened staffs of both regulatory commissions and companies, but particularly of the commissions. So much time is consumed in hearing the cases that the "regulatory lag" becomes itself an investment hazard and has its own adverse effect on the cost of capital to the regulated companies.

Regulatory commissions and the managements of the companies may resort to formulae as means for simplifying the regulatory process. But the use of formulae does not actually avoid the underlying facts, in whatever may be their complexity. Before the formulae may be used with confidence in the circumstances of the proceeding, it must be established that they are adapted to the purpose and will provide fair and reasonable end results. Formulae are most unreliable when they reflect such false propositions as: A percentage ratio of past earnings to market price measures the cost of common stock capital; economic cost is to be disregarded when it varies from accounted-for cost; or, the dollar is a constant unit of measurement.

REGULATORY formulae based on invalid definitions of capital cost often provide results which do violence to common sense. Or the feeling that the results are unfair or unreasonable may be intuitive. The tendency is then to make adjustments or to urge adjustments based on an exercise of subjective judgment.

For example, the cost-of-capital formula may assume that earnings-price ratios are a proper measure of the cost of common

	Company A		*Company B*	
	50% Pay-out	*80% Pay-out*	*50% Pay-out*	*80% Pay-out*
Market price	$100.00	$130.00	$77.00	$100.00
Earnings-price ratio	10.0%	7.7%	13.0%	10.0%
Dividend yield	5.0%	6.2%	6.5%	8.0%

stock capital, but the fair rate of return may be fixed at a level higher or lower than the "cost of capital" as a matter of "expert judgment." Thus, a more or less arbitrary margin might offset the dilution of fair investment values that would be experienced if the rate of return were to be fixed on the basis of the cost-of-capital formula. But how does the commission know that the adjustment is not either inadequate or more than required? Why not recognize that the definition of cost of capital is itself invalid and misleading?

A RATE of return corresponding to a properly defined current cost of capital, applied to a net original cost rate base, will tend to maintain the long-term market value of a company's common stock at some approximation of its book value. A student of rate regulation, vaguely disturbed by the resulting discrimination against common stock investments in public utilities, may suggest that the rate of return be enough higher to establish a market value for the stock at, say, 120 per cent of book value. But why a 20 per cent adjustment in recognition of the fact that the dollar has lost some part of its former purchasing power? Why not 10 per cent or 80 per cent?

Actually, a fair return is incapable of rational determination unless and until it is recognized that the dollar is not a constant unit of measurement and the extent of the change in its purchasing power since the dates of investment is measured and known. Where the rate base is made inflexible, as a matter of administrative policy, the relevant changes in economic circumstances must be reflected in the allowable rate of return if the end result is to be fair and reasonable.

STILL another reaction to the use of irrational cost of capital formulae is the conclusion by some that cost of capital has little or nothing to do with fair return determination. This is, of course, true when cost of capital is given a meaning not logically related to the purposes of rate regulation.

If rate regulation is to proceed on the basis of a meticulous determination of each component of "cost to serve," the definitions should be refined and made consistent with regulatory principles. Cost of capital, properly defined, comes much closer to being the same thing as fair return. Such a cost per dollar of capital has a real meaning as evidence of a fair rate of return.

The cost-of-capital standard, however, should never become a formula. It should be applied with exercise of judgment.

Cost of capital applied strictly as a measure of rate of return provides no margin of reward for efficient management, but on the contrary penalizes managerial efficiency. The better the management the lower the cost per dollar of capital, and the smaller would be the allowable return. Regulation is an acceptable substitute for competition only if it provides appropriate financial incentives to efficient and economical management; otherwise, regulation has the disadvantages of any other price fixing by use of a "cost plus" formula.

AS another illustration, there may be situations, particularly among local transportation utilities, where the value of the service supplied is so low and the demand so elastic that no possible schedule of rates would provide a return corresponding to capital cost.

The rate of return that in fact is fair and reasonable is also influenced by the character of the policies and practices applied in determining operating revenues and allowable operating revenue deductions. Some commissions have employed restrictive practices with regard to includibility of items of operating expense, and the treatment of nonrecurring items of revenue, expense, or taxes. The burden of proof placed upon the public utility with respect to the probable revenue and expense levels of the future period for which rates are being fixed may be made unsupportable.

The regulatory policy may base rates on the revenues and costs that are known and measurable with reasonable accuracy for a past test period, with no consideration of the probabilities for the future.

Restrictive practices of these kinds tend to have an adverse effect on cost of capital unless it is known to investors that the deficiencies are compensated by allowance of a higher rate of return than would otherwise be required.

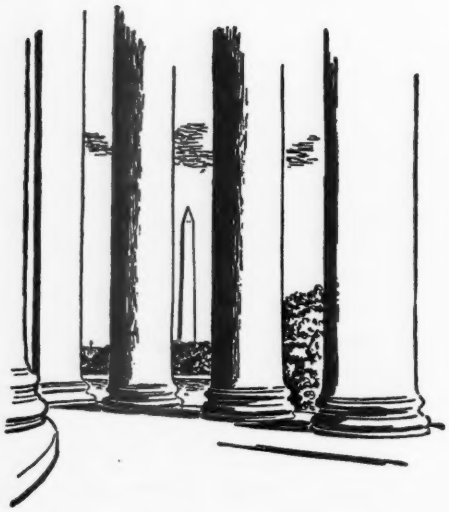
The future prospects of the company should be considered and the rates for service fixed at a level where the intended fair return is reasonably achievable over a significant future period instead of only a few months.

SIMPLIFICATION of regulatory policy and practice is desirable in the public interest. But this does not require adoption of formulae that are inconsistent with the principles of rate regulation. As the general rule, rates are fixed for the future, not for past accounting periods. What is gained by the costly expenditures of time and money to measure the marginal 2 or 3 per cent of "total cost of service" experienced during a past "test year"? In a dynamic economy, the margins of uncertainty as to the return on capital that will be produced by given schedules of rates over a significant future period are much broader. The extensive evidence and highly refined measurement of past results tend to be wasteful. The emphasis ought to be shifted in degree away from "earnings regulation" and toward the establishment of reasonable rates in the light of their function as prices.

A reasonable rate structure is not something to be delicately balanced, as on the edge of a knife. Regulatory determinations ought to be made within the limits of a sensible zone of reasonableness, as an exercise of business judgment in the light of the relevant and guiding standards. And methods may readily be developed to reach these ends without the use of estimates of cost of reproduction less depreciation.

"A GOVERNMENT investigator, testifying before a House subcommittee on how certain government service charges did not meet the actual cost, for instance, telephone service furnished at military installations, noted: 'The price charged was $1.75 per month; the commercial charge, something over $4 per month; the cost for the service varied from $7 to $11 a month.' He said a then proposed $3 monthly raise in the minimum charge (to military and civilian personnel) would bring in more than $500,000 to Uncle Sam."

—EDITORIAL STATEMENT,
Tax Outlook.



Washington and the Utilities

The Preference Clause

THE controversial "preference clause," under which co-operatives, municipal plants, and other public agencies in the utility business get a priority on the right to buy power from federal dams, has become a major bone of contention in the nation's capital these days. The immediate focal point would appear to be the proposed contracts for the sale by the Interior Department of power from the Clark Hill dam to the Georgia Power Company.

Under the contract tentatively approved by the Interior Department, Georgia Power Company would buy the entire output but would sell to co-operatives not in a position to buy their own power at the dam site under terms (as to both supply and rates) reportedly as favorable as those under which the co-operatives could have purchased power directly from the federal government. In fact, if the co-operatives had to construct their own lines in order to buy directly from the federal government at the dam site, the chances are that the resulting cost would be much higher than what they could obtain under the proposed contract.

But Ellis Arnall, former governor of Georgia and counsel for the Georgia Electric Membership Corporation — an association of 37 co-operatives—is not satisfied. In fact he contends that the contract would scuttle the statutory preference in favor of the co-operatives, and he intends to contest in the courts any contract on the proposed basis between the Interior Department and the Georgia Power Company. Interior Assistant Secretary Aandahl has agreed to allow the co-ops another thirty days to go over the proposition (as of early March). They had asked for sixty days.

IF test litigation does actually materialize, it may throw some light on what the preference clause really means. Meanwhile, former Governor Arnall has seemingly contributed a novel interpretation of the provision when he told a meeting of the Georgia co-operatives that such laws as the Flood Control Act of 1944 gives them *title* to power from government-built dams at the "bus bar." In other words, the position taken by Arnall is that the statutory "preference" for public bodies is not entirely satisfied by mere

priority to buy at cut rates for transmission over their lines, if they have them, or after transmission over a utility company's line.

"The heart of the matter is preference to title to the power," said Arnall. "The question of transmission of power and rate schedules can only stem from the possession of title." This is a new concept of the preference provision and legal observers doubt that the courts will hand down any such sweeping definition that Arnall seeks. Because Congress itself has never clearly defined what "preference" really means, any litigation on this score is more likely to leave the matter in the hands of those responsible for administering the laws—in this case the Interior Department.

Arnall told the delegates that "if we can't settle it any other way, we will take it before the Supreme Court." He went on to add that "if the Supreme Court rules that the law is not what we think it means, then we'll abide by the decision, but we'll also try to change the law . . ."

Interior Shifting Ground?

MEANWHILE, there may be a certain amount of changing of positions going on, with respect to interpreting the preference clause, within the Interior Department itself. Last year Interior Assistant Secretary Aandahl originally announced marketing rules for power to be produced at federal dams in the Missouri basin which would, in effect, simply give the co-operatives and other public agencies a priority to buy as much power as they were ready, willing, and able to use at the time the power went on sale. There was an implication that the remainder could be sold to private utility companies on long-term contracts.

Immediately thereafter the cry went up that the co-operatives were being robbed of their statutory birthright, inasmuch as they could not anticipate future requirements and might eventually have to buy additional power from private utilities, now in a position to enter into long-term commitments. Later on an explanatory interpretation was made by Interior, to the effect that no co-operative was going to be shut off in the Missouri basin, as far as reasonably foreseeable requirements were concerned, and that power was being reserved for that purpose.

But even this did not satisfy the public power group. They insist that the "preference clause" represents an absolute priority for co-ops over private companies, regardless of time limit. Therefore, they demanded what amounts to a "recapture clause" in any long-term contract between the Interior Department and a private electric utility. Under this clause, such power supply or part of it could be taken away from a utility at a future time and switched over to a preference customer then ready, willing, and able to buy it.

EARLY in March, Representative Miller (Republican, Nebraska) indicated that a second and more far-reaching concession may be in the making at the Interior Department. Miller, who is chairman of the House Interior Committee, said he was told that all long-range contracts with private utilities will contain clauses for the "recapture" of power if it is needed by co-ops and other "preference" groups. It was the absence of any such recapture provisions (in the original Interior contracts) which aroused the vigorous opposition among co-ops. Miller also quoted Assistant Secretary of Interior Aandahl as saying that no contracts will be signed with anyone except "preference customers" in the eastern half of the Missouri basin. In the western half, preference customers would get first call

on available power; some of the balance will be reserved for their use under short-term contracts. The remainder will go under long-term contracts with a "recapture" clause.

There was no immediate confirmation nor any denial of Miller's remarks from the Interior Department. But, obviously, the inclusion of a "recapture clause" in all long-term contracts would be quite a step in the direction of appeasing the demands of the public power pressure group. All along, Assistant Secretary Aandahl has been insisting that the preference customers "have no exclusive right in perpetuity" to all the power the government generates. An automatic recapture clause in long-term contracts would almost imply such a right, however.

But some electric utility companies fear, possibly to the point of being unwilling to enter into long-term contracts, subject to a "recapture clause," not the present but the future administration of such contracts. Under previous administrations, the power policy of the Interior Department has lent itself to interpretations of such clauses so as to make them an instrument for downright promotion of public ownership. If there were no preference customers in existence, they could be invented and encouraged to make their demands. Thus, the privately owned electric utility companies could never be sure whether they had a power supply or not, under a contract with a recapture clause—if such an atmosphere were to prevail once more in the Interior Department in the years to come.

A court test as to just what the "preference clause" means or what Congress intended it to mean may be the only way of clearing up the uncertainty. And it may be that former Governor Arnall of Georgia will bring about such a test.

The Hinshaw Bill

The Senate on March 16th completed action on the so-called Hinshaw Bill (HR 5976) and President Eisenhower was generally expected to sign it into law. The test of sentiment to this first act of Congress restricting the jurisdiction of the FPC came on a vote to recommit, which was defeated 25 to 52. Six Republicans and the Independent Senator Morse (Oregon) voted with the minority and seventeen Democrats joined the majority. The bill, which has the effect of getting around difficulties growing out of the U. S. Supreme Court decision in the East Ohio Gas Case (1950) 82 PUR NS 1, is essentially contained in the following single paragraph from the text:

> The provisions of this act (Natural Gas Act) shall not apply to any person engaged in or legally authorized to engage in the transportation in interstate commerce or the sale in interstate commerce for resale, of natural gas received by such person from another person within or at the boundary of a state if all the natural gas so received is ultimately consumed within such state, or to any facilities used by such person for such transportation or sale, provided that the rates and service of such person and facilities be subject to regulation by a state commission. The matters exempted from the provisions of this act by this subsection are hereby declared to be matters primarily of local concern and subject to regulation by the several states. A certification from such state commission to the FPC that such state commission has regulatory jurisdiction over rates and services of such person and facilities and is exercising such jurisdiction shall constitute conclusive evidence of such regulatory power or jurisdiction.

Wire and Wireless Communication

Tax Reforms Welcomed by Industry

THE approval by Congress of an overall ceiling of 10 per cent on certain excise taxes brought welcome relief to the communications industries. The ceiling applies to telephone messages, telegraph, as well as plane, train, and bus passenger fares. For the telephone industry, this means a cut to 10 per cent in taxes on local telephone bills, now 15 per cent, and long-distance calls, now taxed 25 per cent. Last-minute attempts on the part of the administration to compromise on a ceiling of 15 per cent failed in the Senate.

Following passage of the bill in the House, Majority Leader Halleck (Indiana) said the cut in excises and the bill to revise the Internal Revenue Code "contain some of the most sensible provisions ever presented in legislation of this type," and demonstrate "that the Eisenhower administration and the Republican Congress are now moving into high gear to fulfill the promises that have been made." Noting that the bill dealing with excises will slash taxes now ranging from 15 per cent to 25 per cent on sixteen items from electric light bulbs and leather goods to theater tickets and telephone calls, Halleck said: "This will mean additional cash in the pockets of every American family man and woman. This one is across the board for everyone."

The bill to revise the Internal Revenue Code faces tougher sledding in Congress than the cut in excise taxes. Democrats already have served notice that they will fight to get more benefits for lower income groups. They have been attacking tax relief for dividend income, the liberalization of depreciation provisions, accumulated corporate surplus, etc. The present law allows investment in dwellings, machines, and equipment used in a trade or business to be recovered by deduction of an equal portion of the cost each year over the useful life of the item involved. The new bill would authorize the depreciation of new facilities at twice the ordinary rate, applied to the unrecovered cost of the asset. As compared with present methods, the effect of this method would be to increase the annual allowances for depreciation of an asset in the early years of its useful life and decrease those in later years. The arguments for this provision are twofold. The first is that present Treasury depreciation policies are too strict and should be liberalized. The second is that more favorable depreciation will encourage capital investment, thereby increasing the productive capacity of the nation and increasing prosperity.

Delaware Utility Statute Declared "Fair Value" Law

IN one of the strongest court opinions in recent years, the Delaware public utility statute was declared a "fair value" law and the state public utilities commission ordered to give "dominant weight" to reproduction cost in determining "fair value."

The ruling, involving the Diamond State Telephone Company's application for higher rates, came from Judge C. R. Layton of the superior court in Wilmington and may be appealed to the Delaware Supreme Court. The company had fixed a fair value of more than $28,000,000. An expert retained by the state commission to compute this figure had set it at $18,637,948, and the commission based its order on a fair value of $22,000,000.

"Contrary to the commission's method of approach," Judge Layton said, "I prefer basing rate base calculations, not upon original cost increased by some nominal, arbitrary percentage designed to replace reproduction cost but, rather, substantially upon reproduction cost decreased by a percentage which ought fairly to compensate for errors inherent in any such study." After weighing several factors, the judge said, he found that the "adoption of a rate base of 90 per cent of the company's reconstruction cost study (April 30, 1953) or, in round figures, $25,500,000, should reasonably approximate the fair, present value of the company's intrastate property.

"Certainly, the difference between this figure and the rate base reflected by the company's study, approximately $29,000,000, should amply compensate for any errors in the company's reconstruction cost study. And this is particularly true because there was probably a sufficient cushion within this reproduction cost study itself to compensate for errors in judgment and the other factors considered.

"In accordance with the commission's method of computation (using an arbitrary figure of $100,000 for cash working capital), and based upon the 6.25 rate of return, an increased net income after taxes in excess of $590,000 annually is indicated. And, if hereafter," the judge continued, "experience should demonstrate that the income based upon such a rate is excessive, which I doubt, then it is always within the province of the commission upon its own motion and upon hearing, to reduce the rates."

IT was indicated at the time that the commission's decision would permit the company about $439,000 additional gross income annually. The company had sought an estimated $1,514,000 additional gross income. Judge Layton said the "decision of the commission is very brief. It contains few findings of fact and is devoid of reasons in support of the conclusions arrived at." Noting the effects of inflation on all phases of the national economy and the increase in the cost of living, the judge said that intrastate telephone rates in Delaware have increased "but 18 per cent and if the full increase requested in this proceeding had been granted, the total increase in such telephone rates would have amounted to 38 per cent. The increase in rates actually granted by this commission together with that allowed in May, 1949, amount to a total rate increase since 1940 of about 24.5 per cent."

The judge noted that "because of sustained demands for service, the company plans to make net additions to its plant of $10,800,000 (1953 through 1955) in order to take care of unfilled orders. Businesses other than utilities may choose the time for expansion but a telephone com-

pany must provide facilities where and when the demands for service arise."

Regarding the basic contentions of the company and the commission, Judge Layton said the disputed rates "were designed to produce for the company annual gross revenues of about $1,514,000, which, after taxes, would amount to $717,600 of additional net income. The commission directed reduction in the proposed rates so that the company would receive an increase in gross income of only $517,000 before taxes. The company based its case for a rate base primarily on reproduction cost less depreciation. The commission in its determination of the company's rate base apparently added 12 per cent weight to original book cost depreciated to allow for reproduction cost of plant."

Transistor Promises Better Phone Service

THE first all-transistor telephone system is being operated experimentally by the Bell Laboratories at Americus, Georgia, with the hope of eventually bringing more and better telephone service to the country's rural areas. The new system lets a number of conversations share a pair of telephone wires without interfering with each other and can operate economically over distances as short as five miles. Other systems not using the transistor, Bell reports, have been able to do this economically only over much longer distances. Transistors, which can do most of the things vacuum tubes can do but require only minute amounts of power, have been used in telephone apparatus before, but this is the first complete system of telephone equipment to use the new devices.

More than 300 of the electronic gadgets will be used in the apparatus at Americus. The result, the telephone company hopes, will be a cut in the over-all size of the equipment to about one-tenth of what it would be if vacuum tubes and their related paraphernalia were used. It is this reduction in size and power requirements that makes the new system economical for such short distances, according to Bell. In fact, the transistors will need so little power that the batteries needed to supply it will be hung right on the telephone poles.

Equipment on each of the lines will consist of a terminal in the central telephone exchange at Americus and another mounted on a pole further out along the line.

O'Hara Bill Nears Passage

THE House-approved O'Hara Bill to exempt small independent telephone companies using radio facilities from the general jurisdiction of the Federal Communications Commission, may be enacted into law before the end of the present session of Congress. The bill has been reported favorably with minor amendments to the Senate Interstate Commerce Committee by its subcommittee on communications. A favorable report by the full committee seems assured and no opposition is expected from the Senate.

Telephone companies using radio frequencies will still have to apply for and receive authority from the FCC as others using radio facilities. But the O'Hara Bill assures intrastate independent telephone companies that they will not lose their present exemption from the general jurisdiction of the FCC through the coincidental use of radio circuits or other radio facilities. Passage of the bill will remove the danger that some small telephone companies might fall under both state and federal control by installing or operating radio equipment as part of their systems' services.

Financial News and Comment

BY OWEN ELY

A Favorable Regulatory Climate in Florida

LEWIS W. PETTEWAY, general counsel of the Florida Railroad and Public Utilities Commission, recently gave a very interesting talk before the New York Society of Security Analysts, explaining regulatory policies in that state. In our opinion these policies in general typify practical and progressive regulatory methods, and commissions in other states might well make a careful study of them. Mr. Petteway's talk is summarized as follows:

The Florida commission, although one of the oldest in the country (originally created in 1887), until 1951 regulated only communications and transportation services. Then, by special act of the legislature, it took over the statewide regulation of electric and gas utilities, which had formerly been in the hands of municipalities and local boards including the nation's only county regulatory agency, the erstwhile Pinellas County Utility Board. In addition to rates and services, the commission also regulates the sale of securities, but it leaves the question of competitive bidding, negotiated sale, or private placement, to the judgment of the utility management.

Public utilities in Florida must spend nearly $500,000,000 in the next five years to keep pace with the growth of the state, Mr. Petteway estimated. Hence the question may have arisen in Wall Street as to whether the regulatory climate in the state is conducive to the successful financing of such a huge expansion program. In other words "Is Florida's regulatory atmosphere sufficiently good and fair to assure the investor not only security, but also an opportunity for his dollars to earn a reasonable and realistic wage?" His talk was evidently designed to show that regulation in Florida is fair to the utilities and favorable for the investors in their securities, while also protecting the interest of consumers, and providing needed capacity.

REGARDING the rate base, the supreme court of Florida in the Jacksonville Gas Case [(1951) 88 PUR NS 420] made a rather exhaustive study of the

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various schools of thought and concluded that the commission should be free to follow whatever philosophy it might choose, since value is affected by changing conditions and these changes may be compensated from time to time by varying the rate of return. The 1951 law directs that "actual legitimate costs of property" should determine the rate base, but this language has not yet been judicially construed.

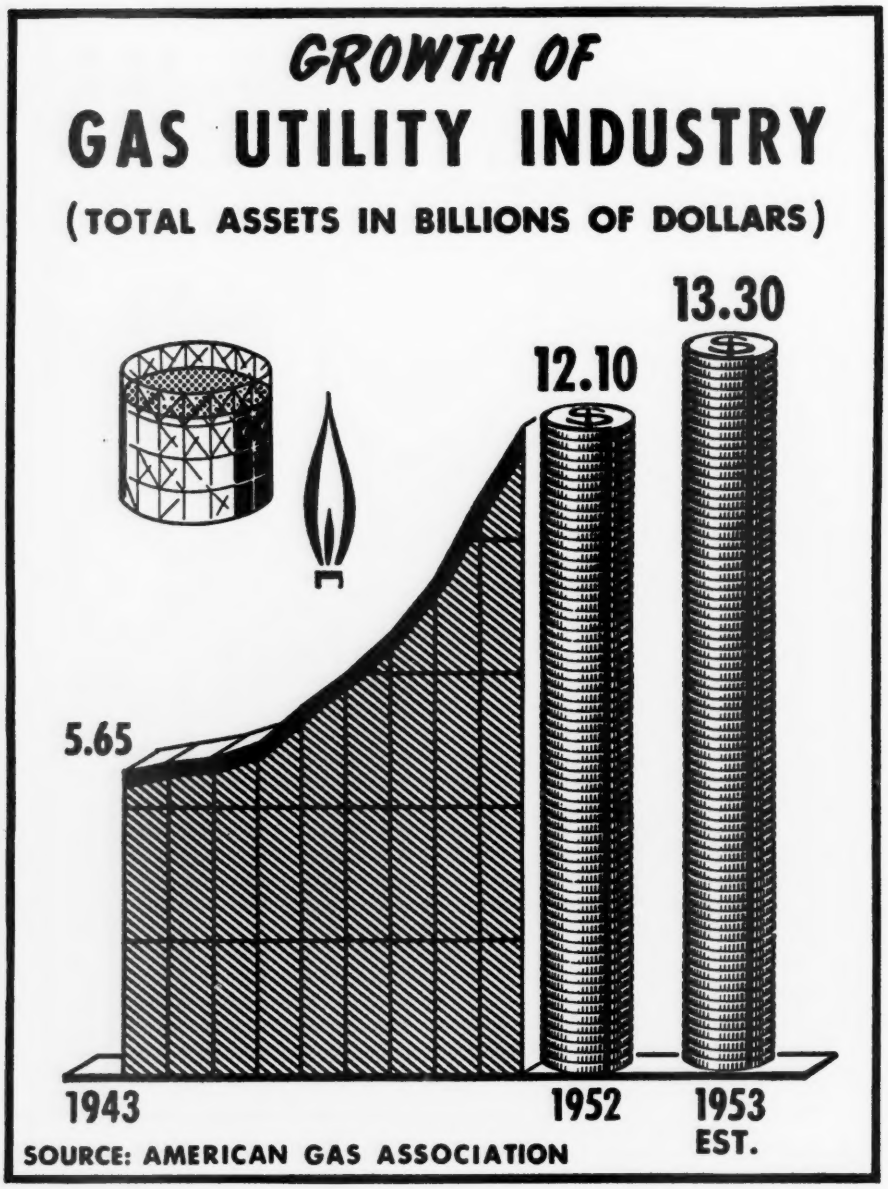
Questioned about "fair value," Mr. Petteway indicated that in his opinion it is unnecessary to consider cost of reproduction in the rate base (even if the statute should be construed to permit it) because a large proportion of the investment in Florida utilities has been made at high prices in recent years. However, his talk indicated that the commission is liberal in its interpretation of "legitimate costs."

REGARDING the method of setting up the rate base, the usual practice is to average the net investment at the beginning and the end of the year. In normal times Florida has followed this method, but now that the utilities are in the "throes" of unusual growth, with net earnings frequently lagging behind investment in new plant, the commission feels that conventional ideas of rate making must be adjusted. In most rate cases, if the average investment for the test year is used, an investment level is assumed which is over a year old by the time the case is decided. The commission feels that such a rate base is unrealistic and bears no relationship to actual conditions. Hence, in the important Florida Power Corporation Case last summer [(1953) 99 PUR NS 129] it used a year-end rate base as a partial offset to the effects of regulatory lag. Mr. Petteway said:

> The Florida commission recognized that there is always a delay or regulatory lag of several months between the time a utility applies for a rate increase and the time a regulatory agency is able to make its final decision on the application, during which period of time the utility suffers what has been called a "transitional loss" which cannot be compensated for by retroactive rates. If such losses incurred through the regulatory lag are further augmented by the adoption of an average investment rate base which coincides with an investment level more than a year old, the utility becomes the victim of confiscation, cannot successfully sell its securities to raise the capital required to finance its expansion program, and the public suffers because it cannot secure essential services.

Petteway's reference to "transitional loss" was probably a reflection of the much discussed "Alberta Plan" (PUBLIC UTILITIES FORTNIGHTLY, issue of February 18, 1954, page 201), under which a credit for such loss is made during the rate-fixing period.

REGARDING the allowance made for working capital, the commission in the Florida Power Corporation Case allowed one-eighth of the annual operating and maintenance expenses and fuel costs plus prepayments at the end of the year properly chargeable to operating expenses. However, advances from customers for construction, contributions in aid of construction, customer deposits, and federal income tax accruals for one-eighth of the year, were deducted from the working capital allowance. With regard to customer deposits, utilities are now adopting a policy of returning these to the customers; also, recent changes in the method of paying corporate income taxes may eliminate these accruals from use as work-



ONE of the fastest growing industries in the United States, the utility gas industry has more than doubled its total assets in a decade. It has gained an average of one million customers per year and expanded its plant by more than one billion dollars every 12 months. The nation's sixth largest industry, it serves more than 27 million customers.

ing capital. Hence, the formula would be subject to change as these credits disappear. In the Florida Power Case, no allowance was made for materials and supplies but the commission's policy is usually to allow this item as an addition to working capital.

It is the commission's policy to allow construction work in progress as part of the rate base. Regarding the more controversial item, Plant Acquisition Adjustments (100.5), the commission eliminated this account in the Florida Power Case since it was considered not particularly important, and the utility had "failed to justify" its inclusion. However, this question is still open and Mr. Petteway's personal view was that, on a proper showing, the item might be included under the 1951 law.

REGARDING rate of return, the supreme court of Florida has held that the rate may be varied from time to time to compensate for changes in value due to changing economic conditions. Thus the commission has allowed small local telephone companies a higher return than the big companies; and telephone companies generally have been allowed a higher return than electric utilities. In 1951-52 returns for telephone companies varied between 6.12 per cent and 8 per cent, depending largely on size; and in 1953 a small telephone company was allowed 7.13 per cent compared with 6.45 per cent for Florida Power Corporation.

In the Florida Power Case, the commission held that a return of 6 per cent would be inadequate for a utility "engaged in a tremendous expansion program which must be financed by the issuance and sale of large amounts of bonds and stocks of the utility." The decision also mentioned the "current cost of capital and the condition of the money market today" (which may have had reference to the rapid rise in interest rates in the first half of 1953, together with the sharp decline in the prices of utility stocks at that time and the resulting higher cost of equity financing).

Regarding readjustment of rates from time to time, Mr. Petteway indicated that the commission allowed some flexibility, but would institute investigations where earnings were obviously too far out of line either way. He pointed out that it had recently reopened a Bell Case where the company had experienced a series of wage increases not taken into consideration in fixing rates six months earlier, and had allowed an additional rate increase. In addition to the usual rate of return, it is now customary in Florida in telephone cases to allow an additional return to offset the depressing effect of current high-cost construction on the earnings rate whenever appropriate showing is made to justify this additional return.

REFERRING further to regulatory lag, Mr. Petteway stated that the commission has adopted every reasonable available device for reducing and minimizing this lag. It compiles statistical data from its records each year and compares the results with those of the previous year to see if any progress has been made. When a rate application is filed, the commission appoints its general counsel to serve as an examiner, to simplify the issues, and to agree on noncontroversial facts and statistics. The utility is also requested to prepare its testimony and exhibits well in advance of the hearing date, to save time. In some cases rates have been permitted to go into effect under bond. Under a recent supreme court decision the commission in the future will separate questions of service deficiencies from the question of revenue requirements, con-

sidering them in separate proceedings, which will save valuable time in rate proceedings.

As another means of regulating rates automatically and reducing the number of rate cases, the commission in the Florida Power Case authorized the use of automatic fuel and commodity adjustment clauses. It was felt that this would tend to adjust rates for inflationary or deflationary price changes and would reduce the number of costly investigations. Thus far these automatic adjustment clauses have been applied only to electric and gas rates but extension to telephone rates would appear logical, it was indicated.

Duquesne Light to Operate 60,000-kilowatt Atomic Power Plant

PROPONENTS of private utility participation in the atomic power development program may be reassured by the recent announcement that the nation's first full-scale atomic power plant will be built at Pittsburgh and operated by the Duquesne Light Company, with the power going over the company's distribution network as part of its over-all generation.

When the Atomic Energy Commission announced several months ago that it would proceed with the construction of a 60,000-kilowatt reactor plant (actual capability may be greater), there was some disappointment that the project had not been farmed out to one or more of the utility companies which has been engaged in research on the subject (as a member of several teams). However, confusion over this program has now been cleared up by the announcement that Duquesne's proposal was the most favorable to the government of nine bids submitted by communities and/or utility companies.

It is not clear, however, to what extent plant and operating costs will be revealed or whether these will remain, for the present at least, as "classified information." It is hoped that the plant can be completed about two years after the formal agreement has been negotiated. Duquesne will contribute the land for the plant and will pay $5,000,000 of the cost of the reactor, or at the rate of about $83 per kilowatt. This cost does not include the cost of the generator, etc. The commission will pay the remaining cost of the reactor, probably about $25,000,000 or more, according to the United Press story. Westinghouse Electric Corporation, which has already built several re-

CURRENT YIELD YARDSTICKS

		1953-54 Range		*1952 Range*	
	Recent	*High*	*Low*	*High*	*Low*
U. S. Long-term Bonds—Taxable	2.50%	3.15%	2.50%	2.78%	2.56%
Utility Bonds—Aaa	2.86	3.43	2.86	3.08	2.93
Aa	2.92	3.59	2.92	3.11	2.99
A	3.15	3.72	3.14	3.31	3.21
Baa	3.60	3.94	3.50	3.58	3.46
Utility Preferred Stocks—High-grade	3.91	4.45	3.91	4.24	3.94
Medium-grade	4.27	4.87	4.27	4.71	4.33
Electric Utility Common Stocks	5.01	5.72	5.01	5.62	5.07

Latest available Moody indices are used for utility bonds and stocks; Standard & Poor's indices for government bonds.

actors for the AEC, including the engine for the submarine *Nautilus*, will design and build the reactor.

On the operating side, the commission will provide the fuel (enriched uranium) and the company will pay the government for the steam used in the turbines at the rate of 48.3 cents per million BTU's for the first year, with the cost increasing annually up to 60.3 cents in the fifth year. The reactor will be of the pressurized-water type, cooled and moderated by ordinary water under pressure —the kind used in the *Nautilus*.

According to *Business Week* (March 13th), the AEC under the prodding of Congress has now decided to devote more of its activities to power development, with the hopes of achieving the goal of cheap power within five years. It is also said that Belgium, which supplies much of our uranium from its Congo territory, is anxious to obtain nuclear power know-how.

Hence, the AEC is planning to experiment with five different kinds of reactors to discover which provides the cheapest and most practicable source of power: (1) The 60,000-kilowatt pressurized-water reactor referred to above. (2) A 15,000-kilowatt "breeder" reactor. (3) A 5,000-kilowatt boiling-water reactor. (4) A homogeneous reactor where "the fuel, the coolant, and the moderator are all mixed together into a radioactive soup." (5) A high-temperature reactor.

Congress has appropriated funds for only the first of these (the Westinghouse-Duquesne reactor), but the AEC may soon try to obtain funds for the other four also.

The figures mentioned above throw little light on the question of ultimate costs. *Business Week* mentioned a plant cost of $45,000,000 as compared with the United Press estimate of $30,000,000. The contribution made by Duquesne of $83 per kilowatt (plus land cost) would seem to approximate one-half of the estimated cost around $200 per kilowatt for construction of a complete fuel-burning generating plant. As regards operating cost, Duquesne is to pay initially 48.3 cents per million BTU's. A reasonably efficient coal-burning plant would produce one kilowatt for about 10,000 BTU's, so that 1,000,000 BTU's should normally produce about 100 BTU's. Thus, the amount to be paid to the AEC for steam would seem equivalent to about 4.8 mills per kilowatt-hour.

Since Duquesne's production cost per net kilowatt-hour at the new Elrama plant in 1952 was only about 2.4 mills per kilowatt-hour (although its average cost at all plants was 4.2 mills and purchased power cost 14.5 mills) this figure would seem a little on the high side, even if Duquesne does not have to maintain the reactor, remove radioactive sludge, and deal with numerous safety precautions and special problems which add heavily to the cost of operating the reactor. Presumably all these extra costs will be absorbed by the AEC as part of the cost of supplying the steam. However, Duquesne is still using, to some extent, the very obsolete Brunot Island plant, where production cost runs as high as 20 mills per kilowatt; to the extent that reactor power supplants this output, there would of course be a saving.

Chairman Strauss of the AEC has estimated that the commission can save $30,000,000 by having the company as a partner in the project, but the basis for the estimate is not given. Presumably it refers to the cost of the land, the generator, and related equipment.

Puget Sound Power & Light Company

For many years the future of this company has been clouded by uncertainties —first by recapitalization problems, next by a long-running fight with the public utility districts and the city of Seattle, then by difficulties over sale of remaining properties to PUD's, and finally by the present contest over a merger with Washington Water Power. In past years outlying parts of the property have been sold, and the proceeds were used mainly for retiring senior securities and providing for necessary construction. Any major expansion program was deferred, however, pending final settlement of the company's problems.

Last November the company's agreements for (1) the conditional sale of major remaining properties to a group of PUD's, and (2) a merger with Washington Water Power, both expired and President McLaughlin announced that the company would now make a fresh start "on its own." To keep stockholders informed, and possibly to counter the arguments advanced by the Stockholders' Committee which is still working for a merger with Washington Water Power, he engaged certain experts to appraise the company's future. One of these reports was prepared by Charles Tatham, Jr., vice president of Institutional Utility Service, Inc., and was published as a 26-page document. The company itself published a 6-page folder summarizing the conclusions of Mr. Tatham and of Professor Cannon of the University of Washington.

At the time of Mr. Tatham's report (January 19th) the company's stock was selling around $24 and he evaluated it at about $33 currently, with a potential of $40-$46 within ten years. (The stock has now advanced to around $28.) In 1953 the company earned $1.85 per share on the common stock and Mr. Tatham projected earnings of $2.35 within three years and close to $2.80 within five years. With earnings around these levels a pay-out ratio of 75 to 80 per cent would mean annual dividend distributions of $1.90 to $2.10 per share as compared with the present $1.50 rate.

An important factor in the earnings of recent years was the sale of a substantial amount of power (over one-fifth of total kilowatt-hour sales in 1952) to the city of Seattle at an average price of less than 4 mills per kilowatt-hour, this contract terminating on February 28, 1953. The company estimated that normal load growth should absorb the equivalent of these sales within two years. Assuming that the power could be sold at an average rate of 1.3 cents per kilowatt-hour, this would mean an estimated increase in earnings of about 80 cents per share. Mr. Tatham felt that other factors would also have a bearing on earnings, and did not make use of this entire potential gain in forecasting a two-year increase of 50 cents in earnings. (It may be mentioned that 1953 earnings benefited somewhat by the rate surcharges permitted by the state commission during the first half of 1953, to compensate the company for the necessity of generating expensive steam power during the earlier drought period.)

Mr. Tatham pointed out that utilities with typical capital structures usually have sold at a price about 40 per cent above book value. On such a basis, Puget would have a potential price in the neighborhood of $35 per share. He also pointed out that the high equity ratio of nearly 61 per cent should enable the company to finance very substantial property growth through issuance of bonds and other senior securities.

RECENT FINANCIAL DATA ON GAS UTILITY STOCKS

1953 Rev. (Mill.)			3/10/54 Price About	Dividend Rate	Approx. Yield	Share Earnings* Current Period	% Increase	12 Mos. Ended	Price-Earns. Ratio	Div. Payout	Moody Bond Rating
		Pipelines									
$ 12	O	East Tenn. Nat. Gas ..	9	$ —	—	$ .62	29%	Dec.	14.5	—	Ba
37	S	Mississippi Riv. Fuel ...	42	$2.40	5.7%	2.70	D17	Sept.	15.6	81%	—
52	S	Southern Nat. Gas	29	1.40	4.8	1.96	NC	Oct.	14.8	71	A
133	O	Tenn. Gas Trans.	24	1.40	5.8	1.65	—	Dec.	14.5	85	A
128	O	Texas East. Trans.	20	1.00	5.0	1.00	11	Sept.	20.0	100	—
63	O	Texas Gas Trans.	17	1.00#	5.9	1.59	42	Dec.	10.7	63	—
58	O	Transcontinental Gas ...	23	1.40	6.1	1.77	38	Sept.	13.0	79	—
		Averages			5.4%				14.1		
		Integrated Companies									
116	S	American Natural Gas .	41	$2.00	4.5%	$3.55	64%	Sept.	12.4	56%	—
18	O	Colorado Interstate Gas .	38	1.25	3.3	1.46	NC	Sept.	—	86	—
232	S	Columbia Gas System ...	13	.90	6.9	.73	D2	Dec.	17.8	123	A
9	O	Commonwealth Gas	10	(a)	4.0a	.41	D53	(c)	—	—	—
9	A	Consol. Gas Util.	13	.75	5.8	1.12	D7	Oct.	11.6	67	—
191	S	Consol. Nat. Gas	58	2.50	4.3	4.11	D2	Dec.	14.1	61	Aaa
107	S	El Paso Nat. Gas	37	1.60	4.3	3.01	38	Nov.	12.3	53	—
32	S	Equitable Gas	24	1.40	5.8	1.88	3	Sept.	12.8	74	A
10	O	Kansas-Neb. Nat. Gas ..	26	1.20	4.6	1.64	D15	(c)	15.9	73	Baa
72	S	Lone Star Gas	25	1.40	5.6	1.50	D3	Dec.	16.7	93	—
19	S	Montana-Dakota Utils. ..	22	.90	4.1	.98	29	Sept.	—	93	Baa
14	O	Mountain Fuel Supply ..	21	1.00	4.8	1.32	7	Sept.	15.9	76	A
49	A	National Fuel Gas	17	1.00	5.9	1.28	—	Sept.	13.3	78	Aa
4	O	National Gas & Oil	8	.60	7.5	.98	42	Dec.	8.2	61	Ba
66	S	Northern Nat. Gas	39	1.80	4.6	2.58	10	Dec.	15.1	70	A
32	A	Oklahoma Nat. Gas	20	1.20	6.0	.89**	D51	Dec.	22.5	135	—
95	S	Panhandle East. P. L. ..	75	2.50#	3.3	4.93	D1	Dec.	15.2	51	A
8	O	Pennsylvania Gas	16	.80	5.0	1.79	D1	(c)	8.9	45	—
130	S	Peoples Gas Lt. & Coke .	144	6.00	4.2	9.72	12	Dec.	14.8	62	A
21	O	Southern Union Gas	18	.80	4.4	1.18	11	(c)	15.3	68	A
209	S	United Gas Corp.	28	1.25	4.5	1.99	40	Dec.	14.1	63	A
		Averages			4.9%				14.0		
		Retail Distributors									
20	A	Alabama Gas	17½	$ .80	4.6%	$1.33	1%	Dec.	13.2	60%	Baa
32	O	Atlanta Gas Light	22	1.20	5.5	1.65	D10	Sept.	13.3	73	A
46	S	Brooklyn Union Gas	29	1.50	5.2	2.12	18	Dec.	13.7	71	A
28	O	Central Elec. & Gas	13	.80	6.2	1.07	14	Nov.	12.1	75	—
10	O	Central Indiana Gas	11	.60	5.5	.55	12	Sept.	20.0	109	A
6	O	Hartford Gas	37	2.00	5.4	2.07	D13	(c)	17.9	97	—
14	O	Houston Nat. Gas	22	1.00	4.5	2.02	53	July	10.9	50	—
12	O	Indiana Gas & Water ...	26	1.40	5.4	1.94	9	Dec.	13.4	72	A
5	A	Kings Co. Lighting	12	.80	6.7	1.11	37	Dec.	10.8	72	Baa
33	S	Laclede Gas	10½	.60	5.7	.89	D10	Dec.	11.8	67	Baa
27	O	Minneapolis Gas	25	1.20	4.8	1.37	21	Sept.	18.2	88	—
11	O	Mississippi Valley Gas ..	19	1.00	5.3	1.97	NC	Sept.	9.6	51	—
8	O	Mobile Gas Service	17	.90	5.3	1.54	17	Sept.	11.0	58	—
6	O	New Haven Gas Light ..	27	1.60	5.9	1.43	D7	(c)	18.9	112	—
8	O	New Jersey Nat. Gas ..	13	—	—	.57	NC	Dec.	—	—	—
162	S	Pacific Lighting	34	2.00	5.9	2.00	D6	Dec.	17.0	100	—
11	O	Portland Gas & Coke ...	22	.90	4.1	1.93	16	Dec.	11.4	47	Baa
8	A	Providence Gas	9	.48	5.3	.41	21	Dec.	22.0	117	—
6	O	Seattle Gas	20	.80	4.0	1.30	11	Dec.	15.4	62	Ba
7	O	South Jersey Gas	19	1.00	5.3	1.34	35	Dec.	14.2	75	Baa
5	O	Springfield Gas Light ...	30	1.80	6.0	1.92	D1	Dec.	15.6	94	—
22	S	United Gas Improvement	34	1.80	5.3	2.24**	2	Dec.	15.2	80	A
33	S	Washington Gas Light ..	33	1.80	5.5	1.68	D21	Dec.	19.6	107	Aaa
		Averages			5.3%				14.7		
		Canadian									
16	S	International Utilities ...	30	$1.40	4.7%	$1.87	—	Sept.	16.0	75%	—

RECENT FINANCIAL DATA ON TELEPHONE, TRANSIT, AND WATER COMPANIES

1953 Rev. (Mill.)			3/10/54 Price About	Dividend Rate	Approx. Yield	Share Earnings* Current Period	% Increase	12 Mos. Ended	Price-Earns. Ratio	Div. Payout	Moody Bond Rating
		Communications Companies									
		Bell System									
$4,417	S	Amer. Tel. & Tel. (Cons.)	163	$9.00	5.5%	$11.71**	2%	Dec.	13.9	77%	Aa
202	A	Bell Tel. of Canada	43	2.00	4.7	2.31	19	Dec.	18.6	87	Baa
34	O	Cin. & Sub. Bell Tel. ...	77	4.50	5.8	5.45	18	Dec.	14.1	83	—
144	A	Mountain States T. & T.	112	6.60	5.9	7.08**	4	Dec.	15.8	93	Aa
237	A	New England T. & T.	120	8.00	6.7	7.50**	3	Dec.	16.0	107	Aa
579	S	Pacific Tel. & Tel.	121	7.00	5.8	7.23	6	Dec.	16.7	97	Aa
74	O	So. New England Tel. ..	36	1.80	5.0	1.87	7	Dec.	19.3	96	—
		Averages			5.6%				16.3		
		Independents									
9	O	Calif. Water & Tel.	17	$1.00	5.9%	$1.56	88%	Nov.	10.9	64%	—
11	O	Central Telephone	17	.90	5.3	1.88**	26	Nov.	9.0	48	—
128	S	General Telephone	49	2.60	5.3	4.05	71	Jan.	12.1	64	Ba
5	O	Inter-Mountain Tel.	13	.80	6.2	.93	43	Dec.	14.0	86	—
14	S	Peninsular Tel.	34	1.60	4.7	2.32	30	Dec.	14.7	69	—
16	O	Rochester Tel.	16	.80	5.0	1.57	NC	Aug.	10.2	51	Aa
6	O	Southwestern Sts. Tel. ..	19	1.00	5.3	1.72	41	June	11.0	58	—
28	O	Telephone Bond & Share	18	—	—	1.52	NC	Sept.	11.8	—	—
15	O	United Utilities	18	1.12	6.2	1.64	10	Sept.	11.0	68	—
195	S	Western Union Tel.	41	3.00	7.3	6.77	243	(c)	6.1	44	Ba
		Averages			5.8%				11.4		
		Transit Companies									
29	A	Capital Transit	13	$1.60	12.3%	$1.16	4%	Aug.	11.2	138%	Baa
14	O	Cincinnati Transit	4	.75	18.8	1.12	—	(c)	3.6	67	—
9	O	Dallas Ry. & Terminal ..	12	1.40	11.7	2.32	D6	(c)	5.2	60	—
229	S	Greyhound Corp.	14	1.00	7.1	1.33	6	June	10.5	75	—
25	O	Los Angeles Transit	10	1.00	10.0	1.15	46	(c)	8.7	87	—
31	S	National City Lines	17	1.40	8.2	1.86	D3	(c)	9.1	75	—
71	O	Philadelphia Transit	5	—	—	Deficit	—	(c)	—	—	Ba
7	O	Rochester Transit	3½	.10	2.9	.26	D77	(c)	13.5	38	—
27	O	St. Louis P.S.A.	14	1.40	10.0	.91	189	(c)	15.4	154	—
17	S	Twin City R. T.	16	1.60	10.0	—	—	(c)	—	—	Ba
24	O	United Transit	3½	—	—	.56	33	(c)	6.3	—	—
		Averages			10.1%				9.3		
		Water Companies									
		Holding Companies									
32	S	American Water Works .	11	$ .50	4.5%	$1.14	75%	Sept.	9.6	44%	—
6	O	New York Water Service	64	.80	1.3	2.37	25	June	17.0	34	—
		Operating Companies									
3	O	Bridgeport Hydraulic ...	30	1.60	5.3	1.62	D7	Dec.	18.5	99	—
11	O	Calif. Water Service ...	36	2.20	6.1	3.12	45	Jan.	11.5	71	A
7	S	Hackensack Water	37	1.70	4.6	2.42	D6	(c)	15.3	70	Aa
4	O	Jamaica Water Supply ..	32	1.80	5.6	2.97	D1	Sept.	10.8	61	A
3	O	New Haven Water	57	3.00	5.3	2.50	D10	Dec.	22.8	120	—
6	O	Phila. & Sub. Water	44	1.00	2.3	4.69	—	(c)	9.4	21	—
2	O	San Jose Water	36	2.00	5.6	2.27	D4	Dec.	15.9	88	—
9	O	Scranton-Springbrook ..	15	.90	6.0	1.17	D4	Sept.	12.8	77	A
3	O	Southern Calif. Water ..	11	.65	5.9	.90	36	Sept.	12.2	72	A
3	O	West Va. Water Service	40	1.40	4.5	1.60**	30	Dec.	—	88	—
		Averages			5.2%				14.3		

A—American Stock Exchange. O—Over-counter or out-of-town exchange. S—New York Stock Exchange. D—Decrease. *Earnings are calculated on present number of shares outstanding, except as otherwise indicated. **On average shares outstanding. # —Includes stock dividend. (a)—Paid 4 per cent stock dividend. (c)—Year 1952. NC—Not comparable.

What Others Think

Utility Unfolds Scholarship Plan

PENNSYLVANIA POWER & LIGHT COMPANY'S scholarship plan, designed to provide educational opportunity for local young men and women and to offer financial assistance to central eastern Pennsylvania's independent institutions of higher learning, was recently unfolded by the company's president, Charles E. Oakes. Because all free enterprise industries, utility companies included, are affected by the financial problems confronting the independent colleges of the nation today, the program recently authorized by Pennsylvania Power & Light's board of directors should be of interest.

Under the plan, six scholarships will be available to youths whose parents are residents of the company's service area and customers of the company or its subsidiaries. At least one of the scholarships will be available to a son or daughter of an employee. Each scholarship recipient will be entitled to $500 to be paid toward his or her tuition during the scholarship year. In addition, a like sum will be paid in the scholarship year to the college or university which the recipient or grantee attends, the latter sum to be used "in whatever manner the college or university finds will contribute most constructively toward worthy educational objectives."

In announcing the PP&L plan, Oakes stressed its twofold nature. "More than ever," he said, "America needs college men and women with the ability to think, evaluate, and build—the type of people who have contributed so much to American progress. Here in our service area are highly capable young people whose only barrier to higher education is inadequate funds. Our purpose is to help some of these deserving youngsters."

Oakes pointed out that granting of scholarships alone does not help but can actually inflict serious financial problems on the educational institution. Too frequently a scholarship today, he said, pays only a portion of the school's cost of educating a student and thus, scholarships alone may increase the financial burden on the institution. Therefore, PP&L has included in its plan a provision for an additional payment to the educational institution apart from the tuition payment so that the college will, in effect, be reimbursed for its cost of educating the scholarship student.

ACCORDING to the utility president, the serious financial plight of the country's privately owned colleges and universities is reflected in a recent national study. This indicated that more than one-third of the nation's private colleges and universities might operate in the red at the end of the current school year. A four-

fold increase in operating expenses since 1930 and the inability to secure endowments and gifts from individuals were given as reasons.

The increase in operating expenses has increased the colleges' need for dollars by 400 per cent during a period in which the value of the dollar has decreased almost 50 per cent, Oakes pointed out. Today, he added, the tuition fee cannot be increased in proportion to costs unless the colleges price themselves out of business, thus denying many worthy students the benefit of higher education because of financial reasons. Income from endowments, which once was sufficient to make up the deficit between tuition and the real cost of education, has fallen from 22 per cent in 1930 to 8 per cent in 1950. This situation has arisen, said Oakes, because the substantial accumulation of savings by successful businessmen and the large inheritances of individuals, which in the past provided the source of endowments, has become virtually impossible under existing tax laws.

In formulating its twofold scholarship plan, Oakes explained, PP&L has taken the lead with a number of other business corporations throughout the nation, which also believe that American business and industry have a responsibility that justifies, if not demands, support to education. Each June, he added, corporations eagerly recruit college men and women who represent the great diversity of talent and training required to meet today's problems of business and industrial management. Colleges have received little or nothing from businesses in return for supplying these trained people.

"If the business corporation does not sense and react to its educational responsibilities," Oakes pointed out, "the government will be forced to step in with subsidies, for the American public will demand higher education in some form. Once all schools are forced to accept government subsidies, they surrender their freedom to the government that meets their deficit and opens the way to nationalization of all education. We cannot expect a free exchange of ideas to prevail under a controlled educational system. Thus we face loss of the free-thinking type of individual who has contributed so much to our civilization in the past and on whom we must rely so heavily in the future."

SCHOLARSHIP recipients will be free to select any recognized course of academic study which leads to a degree, under PP&L's plan. The selection of applicants and grantees is the responsibility of a three-man Scholarship Awards Committee, the members of which have recognized standing in the educational field and none of whom have been graduated from, or otherwise intimately connected with, any educational institution in the company's service area.

State Chambers of Commerce Urge Flexible Depreciation Allowances

THE revision of the Internal Revenue Code presently being undertaken presents Congress with an excellent opportunity to give the nation's economy a strong shot in the arm with lasting effect, according to a study prepared for the 31 state and regional chambers of commerce in the council of state chambers of commerce. Although the House Ways and Means Committee has reported a tax revision bill with more flexible depreciation allowances, the Democrats in Con-

gress have singled out this provision for special attack and are expected to make strenuous efforts to retain the existing provisions on this subject.

The need for reasonable depreciation allowances has always been recognized under federal tax laws. Even now the Internal Revenue Code permits deduction in computing net income of a "reasonable allowance for exhaustion, wear, and tear (including a reasonable allowance for obsolescence) of property used in the trade or business . . ." Prior to 1934, the decision on rates of depreciation used was for the most part in the hands of management. In practice the burden of proof as to unreasonableness of rates taken was on the Treasury, which ordinarily disallowed them only if they were clearly extravagant. In 1934, however, this relative freedom in determining depreciation allowances was taken away from taxpayers in a move to increase revenues temporarily. At that time the House Ways and Means Committee was considering a proposal to raise additional revenues by a 25 per cent reduction in depreciation allowances for three years. In view of the strong objections to this proposal, the Treasury suggested that an equivalent amount of additional revenue could be obtained by requiring that assets be depreciated over their "useful lives" and by shifting the full burden of proof as to rates to the taxpayer. This recommendation was then placed into effect by the Treasury through changes in its own regulations.

In order to carry out its new policy, the Treasury prepared "useful life" schedules of various types of depreciable assets and they have been the basis for forcing taxpayers to depreciate assets over a longer period than they otherwise would. These schedules were first published in 1934, and they have been revised only once—in 1942. Since the obsolescence factor alone changes from year to year, the schedules do not reflect adequate depreciation for many assets. Yet the Treasury still insists that they be used in determining depreciation allowances. While the Treasury recommendation of 1934 was supposedly adopted as a method of temporarily increasing revenues, it became the basis of a drive for lower depreciation allowances that revenue agents have conducted for almost two decades. In May, 1953, the Commissioner of Internal Revenue called a halt to the practice of questioning existing depreciation allowances unless there were convincing reasons for changing them. This action helps to avoid controversies over current rates of depreciation but does not give taxpayers needed flexibility in setting future rates.

The restrictive depreciation policy adopted by the Treasury in 1934 has had several bad effects, according to the study. Here are some of them:

(1) Because of low annual depreciation allowances spread over a long period, businesses have hesitated to invest in new equipment before the old was fully depreciated. Consequently, inefficient and obsolete equipment has been kept in use with the result that production costs and prices to consumers have been higher than they would have been with new and improved equipment.

(2) The obsolescence in industry caused by low depreciation rates has not only caused higher costs of defense but has endangered the defense program itself. This was recognized by Congress in the last three war emergencies when it authorized rapid depreciation of specified defense production facilities to speed up the mobilization program.

(3) The unrealistic depreciation

charges caused by the low Treasury-approved rates have resulted in businesses reporting profits which did not exist but on which taxes had to be paid.

(4) The reporting of such phony profits has often caused payment of dividends which in reality came from capital rather than from income.

ON top of this, the study continues, the inflation of prices since 1940 has furthered the damage to the economy caused by the enforced low depreciation allowances. While low rates alone tend to discourage investment in modern equipment before the old and inefficient is fully depreciated, the inflationary price of the new item makes replacement of the old doubly discouraging. Equally serious is the inroad on capital caused by price inflation, coupled with low depreciation rates. Enterprises with a large investment in depreciable assets in relation to annual sales are especially affected, and the ones hurt most of all are the public utilities which not only have large capital investments but also lack freedom to adjust sales prices to offset inflationary costs.

A removal of the present restrictions on the freedom of taxpayers in determining depreciation policy would be a substantial aid in reversing the present recessionary trend and in preventing future depressions, the study states. It would affect the nation's economy in these ways:

(1) The incentive of being able to recover a major part of investment in the early years of the life of assets would result in a wave of orders for new machinery and equipment and it would generate new building programs in industry. This would bring back laid-off workers and often create new jobs all along the line from those who produce raw materials through those who operate the plants and equipment.

(2) The incentive to buy new productive tools sooner would result in better products at lower costs available to more people. This will further help the wage earner all along the line from producers of raw materials to consumers.

(3) Early depreciation of productive assets would shorten the replacement cycle and maintain a high production level in the machinery and equipment industries which under present depreciation regulations operate in a feast and famine cycle.

(4) The national security would be strengthened by the incentive to keep industrial plants as modern and efficient as technological improvements permit.

(5) The small manufacturers and farmers, who in the aggregate are large users of machinery, would benefit particularly. It is they who are most repressed by restrictive depreciation because of their greater difficulty in financing necessary replacements and expansion.

(6) Flexibility would make possible the reporting of true income and eliminate taxation of capital in the form of fictitious profits which occurs under present depreciation rates. The levying of taxes on capital which is caused by inflation would be minimized for most industries.

PRESIDENT Eisenhower recommended that more freedom be allowed business in using straight-line (constant rate) depreciation and in selecting other methods of depreciation. Specifically, he proposed that larger depreciation charges be allowed in the early years of property life by the use of the declining-balance method at rates double those permitted under the straight-line method, or by other methods so long as they do not produce deductions greater than available under the declining-balance method.

The March of Events

Court Sustains Tidelands Law

THE U. S. Supreme Court on March 15th upheld the Eisenhower-backed Submerged Lands Act which ceded oil-rich offshore lands to coastal states.

A brief, unsigned opinion said the Constitution gives Congress unlimited power over the public lands. And, the opinion added, it is not for the courts to say how that trust shall be administered.

The recent decision came just before the court recessed until April 5th. Chief Justice Warren, former governor of California, disqualified himself in the submerged lands case. Justices Black and Douglas read sharply dissenting opinions.

Thus the court rejected by a vote of 6 to 2 requests by Alabama and Rhode Island for permission to file suit against four other states—Texas, California, Louisiana, and Florida. The latter four states are expected to get the lion's share of benefits from the 1953 law.

AGA Fall Convention Mapped

A PROGRAM of speeches by recognized authorities will be featured at the thirty-sixth annual convention of the American Gas Association in Atlantic City, New Jersey, October 11th to 13th. Basic plans for such a program were outlined at a meeting of the general convention committee in New York city recently under Chairman Everett J. Boothby, president of Washington Gas Light Company.

Among the subjects presented for final selection by the committee for the general sessions are: regulation, legislation, natural gas future prospects, supervisory training, increasing costs of natural gas, and possibly a panel discussion.

Arizona

Senate Approves Utility Bill

A BILL intended to prevent a municipally owned public utility from competing with a privately owned public utility was passed by the state senate recently and sent to the house.

In instances where a municipality desired to extend a utility service to an area served by a private concern, the bill would require the city or town to acquire the private utility. Although the language of the act would cover other types of utility services, it was designed to cover only municipal competition with private water companies. The measure was viewed as a vital factor in future annexation plans of

municipalities, especially Phoenix and Tucson. The legislative issue developed after the state supreme court held that the city of Tucson had a lawful right to parallel a private water utility line in a newly annexed area.

Kentucky

Utility and Co-op Sign Agreement

AN agreement for the interconnection and integration of their generating and transmission systems was signed early last month by Kentucky Utilities Company and East Kentucky Rural Electric Co-operative Corporation.

The contract was signed in the offices of the state public service commission at Frankfort. R. M. Watt, president of KU, signed for his company; Alex B. Veech, president, signed for East Kentucky. The agreement was effective March 1st, subject to the approval of the state public service commission and the REA Administrator.

Judge Robert Coleman, chairman of the state commission, termed the agreement the first of its kind in the United States. "We hope," Coleman said, "that this contract establishes a pattern for better relations between the rural electric corporations and electric companies throughout the country. It attests to a high quality of business statesmanship on the part of the management of both organizations.

Nebraska

City Loses Court Battle

FEDERAL District Judge John W. Delehant recently ruled against the city of Hastings on all counts in a suit brought four years ago by the Kansas-Nebraska Natural Gas Company. The company filed suit for declaratory judgment in January, 1950, and sought an injunction a short time later to prohibit the city from using town border station gas at the power plant.

The town border station is the point where the company delivers the gas to the distributor, in this case the city.

Judge Delehant in a two-hour oral decision held Kansas-Nebraska's contract with the city for the sale of gas to the city power plant is valid. He ordered the city to pay according to the terms of the contract, plus interest and court costs.

The judge also granted a permanent injunction effective next May 31st, forbidding the city to use the town border station gas at the power plant.

New York

Power Authority Chairman Confirmed

ROBERT MOSES was confirmed recently by the state senate as a member of the New York State Power Authority. The vote was 35 to 1.

Most Democrats expressed their admiration for the New York expert in public construction projects, but protested that Mr. Moses should have been called for questioning on his stand on the power issue.

The authority will have control over

the construction of the $600,000,000 St. Lawrence river hydroelectric project, and the Niagara Falls power project, if permission to develop it is ever granted the state.

Mr. Moses was scheduled to succeed John E. Burton as chairman. Mr. Burton will remain as a member of the committee.

U. S. Representative Franklin D. Roosevelt, Jr. (Democrat, New York), said New York state's plan to build new power plants at Niagara Falls was "only the first step in the program of the private utility companies to eliminate the municipal and rural co-operative systems." Mr. Roosevelt is co-sponsor with Senator Herbert H. Lehman (Democrat, New York) of a bill to permit the state to build the new plants.

The measure differs with one favored by Governor Dewey of New York in that the Lehman-Roosevelt proposal provides for a preference to public bodies such as co-operatives and municipal agencies in the distribution of the power to be generated.

Governor Dewey is against the clause.

Natural Gas Bid Made

CONSOLIDATED EDISON COMPANY has asked the state public service commission for authority to substitute natural gas for the mixed gas now supplied 670,000 consumers in Manhattan and 430,000 in the Bronx.

In announcing the request, Consolidated Edison stated that the changeover would save $4,700,000 a year in operating costs, once it has been completed.

Natural gas is supplied at present to the company's customers in Westchester, most of Queens, and the Riverdale and City Island sections of the Bronx. The changeover is in progress in Astoria and Long Island City, Queens.

The changeover to natural gas requires adjustment of consumers' appliances. The company will do this work at an estimated cost of $22,000,000 in the Manhattan and Bronx areas affected. It will take four years to make the changeover, if the commission approves the request.

Rhode Island

Able Commission Staff Urged

THE chairman of the Connecticut Public Utilities Commission told the corporations committee of the Rhode Island senate last month that the $200,000 spent to investigate recent telephone rate increases in Rhode Island could have financed a state staff of utility experts for years.

Eugene S. Loughlin, who heads the Connecticut commission, visited the state house at the request of Governor Roberts, who wants the legislature to pass a law similar to Connecticut's law for regulating public utilities.

The governor's proposal would compel utilities to pay 45 per cent of the cost of operating the state public utilities office, which regulates the utilities. The bill has passed the house and was in the senate corporations committee.

The governor plans to staff the utilities division with at least an additional accountant and engineer who are expert in public utility operations.

Loughlin said he thought it was unconstitutional to forbid—as the governor's bill does—the utilities to pass on to the consumer their share of the cost of keeping up the utilities division. The amount, however, would be so small that it would not enter as a factor for establishing rates.

Progress of Regulation

Percentage of Increased Gas Cost to Be Absorbed

THE Colorado commission dismissed objections to its jurisdiction over a combination utility's charges for gas service within a municipality notwithstanding the contention that a "home rule" city is exempt from commission regulation.

Emergency Rate Increase

After deciding this point, the commission ruled that inasmuch as the company's supplier had received a temporary rate increase from the Federal Power Commission, it would be proper for the company to pass on to its customers part of the increased cost. The principal question to be determined, the commission continued, is the amount of the increase which the company could safely absorb without jeopardizing its financial condition and at the same time share with its customers a part of the increased costs.

Percentage of Absorption

The commission set out in table form the various rates of return which would result for both the total company and the gas department only based on a 100 per cent pass on of the increase to the gas customers, a 100 per cent absorption of the increase by the company, and a 16⅔ per cent absorption by the company. All were calculated using property, plant, and equipment based on original cost with materials and supplies added and depreciation reserve deducted.

The commission concluded that a 16⅔ per cent absorption was proper and would permit a return of 6.33 per cent to be earned from the new rates. These remarks were made concerning the considerations affecting this determination:

> In arriving at our conclusions herein as to what amount should be absorbed by the company and what amount passed on to the customer, we have considered certain basic elements, both as to rate of return and as to elements that could be considered legitimate components of a rate base, without, however, going into a full-scale rate hearing to determine the exact amount of these elements. We feel justified in this instance in using this procedure because of the very nature of the problem confronting us, with the time element involved, the emergency nature of the temporary increase, and the fact that the motivating cause for the increase is beyond the direct control of either the company or the commission.

Electric Department's Burden

A contention that electric customers should share the burden of the increase because of the use of gas in generating plants was disallowed. Electric rates, the

commission said, are not involved in this proceeding, and will be considered when the company completes studies as to the effect of the increased cost of gas upon the expense of rendering electric service. *Re Public Service Co. of Colorado, Investigation and Suspension Docket No. 361, Decision No. 41845, January 7, 1954.*

Telephone Territory Declared Open to Qualified Company

ONE of several typical service investigations recently completed by the Indiana commission concerned a telephone company which had ignored commission orders directing repairs and rehabilitation. The record indicated that over a 5-year period the company had made no attempt to make repairs of even a temporary nature. The state public service commission ruled that as a result of the telephone company's neglect of its service obligation, its certificate should be revoked and its territory declared open to any qualified company desiring to render the service. *Re Lizton Teleph. Co. No. 23318, January 28, 1954.*

Contributions in Aid of Construction Excluded from Net Worth Determination

A MUNICIPALITY had been split in two and a new city formed under separate corporate charter. Prior to that, the water utility had been owned and operated by the municipality, had rendered service to all the inhabitants of the town, and contemplated continuing service to those in the area of the new city.

The Wisconsin commission was asked to determine and certify the value of the utility property so that the apportionment boards could adjust the assets and liabilities between the respective municipalities.

The commission was of the opinion that it had the duty to determine the value of the property and would do so, but took exception to the treatment the new city proposed for contributions in aid of construction. The amount of such contributions, particularly those comprised of federal grants, in the opinion of the commission, should not be added to the net worth of the town for the purpose of applying the rate apportionment. It said:

> The commission has consistently followed the practice, in its rate-making functions, of deducting contributions before determining the rate of return due the municipality. In other words, the contributions or donations were made without hope or intent of receiving a return thereon or any reward other than the obtaining of water service at a reduced price for the customers. The donations were made for the benefit of the consumers of both the town and those now residing in the city; and equity would seem to indicate that the city should not now be heard to claim that they should receive compensation for a portion of the water utility which was never paid for by them either directly or indirectly. Any different consideration of these contributions for the purpose of determining the compensation to be paid to the city of St. Francis would have the concomitant effect of resulting in an increase in the rates for service to the water consumers in that city inasmuch as the town of Lake

would then be justified in requesting an increase in rates to provide a return on the increased equity paid for by that town. Without an increase in rates it would be tantamount to receiving double compensation: first, by the city receiving payment for the contribution; and, second, by the consumers, residing in the city, receiving rates predicated on no return for the capital represented by such donation. We cannot bring ourselves to the conclusion that either equity or the law can justify such a procedure.

Re City of St. Francis, 2-U-3996, January 25, 1954.

Double Rate for Nonresidents Not Discriminatory

THE court of civil appeals of Texas affirmed a lower court decision dismissing a suit brought by nonresident water users against a city. The customers' chief complaint was that a city ordinance required them to pay twice as much for water service as city residents.

The court ruled that the ordinance was not discriminatory because there was a reasonable basis for the higher rate. It was clearly more costly for the city to serve the large area, extending as much as eighteen miles beyond the city limits, particularly in the fields of maintenance of lines, pumping and lifting service, and meter reading.

Finally, the court made this comment about responsibility of city residents:

> Another fact which deserves consideration as tending to justify a higher rate to outside users is that the waterworks system of the city of Abilene was purchased by general obligation bonds of which more than $4,000,000 are now outstanding. The residents of the city are liable through taxation for the payment of the principal and interest on these bonds and they constitute a charge or incumbrance upon the taxable property within the city.

Botkin et al. v. City of Abilene, 262 SW2d 732.

Coke Company Retained in Integrated Gas System

THE Securities and Exchange Commission held that a natural gas company's continued retention of a coke company subsidiary was permissible under the "other business" clause of § 11 (b) (1) of the Holding Company Act. Previously, in approving a holding company integration plan involving retention of the coke company (1947) 73 PUR NS 324, the commission had reserved jurisdiction as to its retainability whenever natural gas might be available to the gas company. The latter has since converted to natural gas.

The "other business" provisions of the act have been construed in the light of the statutory policy to achieve "economy of management and operations" and "the integration and co-ordination of related operating properties." They require that there be a functional relationship between the operations of the utility system and the nonutility business sought to be retained. Retention must be in the public interest or for the protection of investors or consumers. Retainable nonutility interests should occupy a clearly subordinate position to the integrated system consti-

tuting the primary business of the holding company.

Operating Relationship

Prior to the utility's conversion to natural gas, the coke company subsidiary was the utility's major gas supplier. Now the coke company sells part of its production of coke oven gas to the utility for resale without profit to a municipal sewerage authority under contract. The contract provides for the availability to the utility of all coke oven gas produced in the event of emergencies.

Service to the sewerage authority may be cut off only because of a pipeline break. In the event of a service interruption to the authority for seventy-two hours, the utility must furnish fuel oil or gas oil sufficient to operate the sewerage plant, or make up the difference between the price of such oil and the price of coke oven gas which would otherwise have been supplied. Therefore, the availability to the utility, under the arrangement with the sewerage plant, of stand-by reserve in the event of emergencies represents a material benefit to the utility's consumers despite the absence of a profit.

The commission concluded that although the coke company's revenues from coke and chemicals have increased substantially while those from gas have decreased, the industrial character of the company has not reached such proportions that divestment is required. *Re United Light & Railways Co. Release No. 12317, January 22, 1954.*

Nonuser Denied Damages Due to Gas Service Restrictions

THE Ohio court of appeals has affirmed a lower court decision dismissing a gas appliance dealer's suit against a gas company for damages due to loss of business during a period when space-heating service was curtailed. The company successfully defended on grounds that it had not refused to serve space-heating customers who had qualified by obtaining permits under the emergency gas restrictions imposed by the Ohio commission.

The appliance dealer did not claim that any of its customers had been refused service by the gas company. Nor was it claimed that he would have installed heating units except for the utility's action. He merely claimed that he "would have installed or been able to install."

The court did not believe this was a case in which a public utility failed to perform its public duty. It held that unless it could be shown that the company had refused to serve a qualified customer, or had acted in bad faith with respect to a customer's qualifications, the appliance dealer could not claim damages because of loss of business from anticipated sales.

Utility Obligation

The company, as a public utility, owed no duty to the claimant as a dealer in heating appliances, the court said. It had no obligation to promote the dealer's business. In relation to the public, other than in the furnishing of gas, the company acted in its private capacity governed by the same rules that are applicable to private corporations, subject only to the limitation that it could not in any way deprive itself of its ability to perform its public duty by any action it might take in its private capacity.

Legislative Intent

The sole purpose of the statute under which this action was brought was to regu-

late gas companies in discharging the obligation they had assumed. The court concluded that the dealer's hope of profit from its business was not an "interest" within the contemplation of the legislature when it passed the law. The only interest contemplated was that which might result from the consumption of gas.

The commission rules restricting service were, according to the court, promulgated to regulate and conserve gas so as to enhance the ability of the company to supply it in such a way as to promote the public welfare. The court did not believe that to impose liability upon the company in favor of a gas appliance dealer would insure the company's duty to furnish service. To construe the statute as imposing a liability for damages to the appliance business, said the court, would be to declare that it was the appliance business that the legislature intended to regulate and protect.

The court considered the possibility of liability in tort based on interference with contract relations between the appliance dealer and his customers. In rejecting this possibility, the court said that the inapplicability of this principle results from the fact that there is no allegation of any contract between the dealer and a customer that was interfered with by the gas company, or that any customer was prevented from entering into a contract with the dealer. *Floyd & Co., Inc. v. Cincinnati Gas & E. Co. February 8, 1954.*

Other Important Rulings

Monitoring Service. The Ohio Court of Common Pleas held that a telephone company could monitor the telephone of a customer suspected of using residential service for business purposes without incurring liability for invasion of privacy. *Schmukler v. Ohio Bell Teleph. Co. 116 NE2d 819.*

Surcharge for Manufactured Gas. The Massachusetts department held that a gas company which had converted to natural gas should continue to supply a municipal gas plant with manufactured gas and recover monthly losses for so doing by a surcharge added to the regular rates, where the municipality could not obtain natural gas due to a Federal Power Commission prohibition against serving utilities not qualified under the Natural Gas Act. *Town of Middleborough v. Brockton-Taunton Gas Co. DPU 10371, January 22, 1954.*

Water Company Return. A return of 6 per cent was considered fair and reasonable for a water company by the New Jersey department. *Re Portaupeck Water Co. Docket No. 7471, January 13, 1954.*

Elimination of Crossing. Any plan adopted for the elimination of railroad grade crossings, commented the New York commission, should assure expenditure of state funds in a wise and prudent manner and should not violate long-standing municipal policies of area development. *Re Long Island R. Co. Case 11626, January 14, 1954.*

Municipal Plant Return. A return of 5.5 per cent was considered fair and reasonable by the Wisconsin commission for a municipal water plant. *Re City of Kenosha, 2-U-4127, January 15, 1954.*

Train Discontinuance. The Wisconsin commission allowed a railroad to discontinue certain passenger trains provided a

substitute bus service was established and maintained at approximately the same hours as the trains operated, where the evidence showed that the service was not required, that private automobiles had largely supplanted the use of railroads in the area, and that the carrier was suffering a substantial loss on the operations involved. *Re Chicago & N.W.R.Co. 2-R-2088, January 15, 1954.*

Switching Nuisance. The Pennsylvania commission held that it did not have jurisdiction over a complaint alleging a railroad had created a public nuisance by changing shifting, switching, and rerouting operations in residential sections of a city from the daylight hours to the late evening and early morning hours. *Borough of Clifton Heights v. Pennsylvania R. Co. Complaint Docket No. 16011, February 1, 1954.*

Train Discontinuance. The factors to be considered in determining whether a railroad should be authorized to abandon certain passenger service, commented the Wisconsin commission, are the present and prospective use by the public, the extent of the loss on the operations involved and its relationship to the carrier's overall operation, and the availability and adequacy of other transportation. *Re Chicago & N.W.R.Co. 2-R-2698, February 2, 1954.*

Turkey Talk. The Wisconsin commission decided that a city ordinance establishing a special higher sewer rate for a customer conducting a turkey farm and market on his premises was unjustly discriminatory where a septic tank provided the sewerage facilities for the turkey business and the customer was receiving only domestic sewerage service for a one-family dwelling. *Jaeger v. City of Cedarburg, 2-U-4048, February 4, 1954.*

Construction of Statute. The Tennessee Supreme Court commented that federal decisions should be considered particularly persuasive in resolving questions arising under a state statute which is modeled after a federal statute. *Hoover Motor Express Co., Inc. et al. v. Railroad & Pub. Utilities Commission et al. 261 SW2d 233.*

Private Carrier. A poultry company which leases trucks and transports its own goods in interstate commerce is a private carrier, held the United States Court of Appeals, and is not required to obtain either a certificate or a permit. *Interstate Commerce Commission v. Woodall Food Products Co. 207 F2d 517.*

Construction of Crossing. The fact that a railroad holds an unencumbered title to land used as a right of way, held the Louisiana Supreme Court, does not prevent the commission, in the exercise of the state's police power, from requiring the railroad to construct and maintain, without compensation from the state, a crossing reasonable and necessary for the public use. *Illinois C. R. Co. v. Louisiana Pub. Service Commission et al. 69 So2d 43.*

Alternate Routes. The Interstate Commerce Commission may properly authorize a water carrier to employ any means of transportation necessary to carry out freight-forwarding activities, held a United States district court, where the carrier, which has been operating at a financial loss, is seeking alternate means of transportation to attain a sound financial policy and to cope with interruptions in service caused by West coast labor disputes. *Acme Fast Freight, Inc. v. United States et al. 116 F Supp 97.*

Eminent Domain. The Louisiana Supreme Court commented that the commis-

sion need not determine the common carrier status of a corporation before the corporation may exercise the right of eminent domain. *Calcasieu & S. R. Co. v. Bel et al. 69 So2d 40.*

Variance of Tariff. A United States district court commented that the legally published tariff of a carrier engaged in interstate commerce may not be avoided, enlarged, or varied by a contract between the shipper and carrier, or by the tort of the carrier. *United States v. Kansas City Southern R. Co. 116 F Supp 484.*

Delay in Shipment. A United States district court held that although an express company is not bound to transport by any particular train or vessel or in time for any particular market, it has a duty to transport with reasonable dispatch, and a 16-hour delay in shipment of a perishable commodity constitutes a breach of such duty. *Railway Express Agency v. Smith, 116 F Supp 609.*

Rate Making by Court. The Alabama Supreme Court commented that, although it had the power to determine the constitutionality of rates imposed for public utility service, it could not fix such rates. *Water Works & Sanitary Sewer Board of Montgomery et al. v. Sullivan et al. 69 So2d 709.*

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MINNESOTA RAILROAD AND WAREHOUSE COMMISSION

Re Northwestern Bell Telephone Company

M-3616
January 8, 1954

APPLICATION *for authority to increase intrastate telephone rates; higher rates prescribed.*

Valuation, § 299.1 — Working capital allowance — Tax accruals.

1. The commission, in fixing a working capital allowance for a telephone company for rate-making purposes, considered the fact that the company collected substantial sums for service in advance and had an accumulation of tax reserves out of earnings which it could hold for many months at a time, p. 35.

Return, § 31 — Reasonableness — Pending construction.

2. The effect of a large-scale construction program on a telephone company's earnings was considered by the commission in fixing rates, in view of the need for the construction to meet the increasing demand for service, p. 36.

Return, § 111 — Telephone company.

3. Rates which would yield a return of 6.29 per cent were authorized for a telephone company, p. 36.

Rates, § 134 — Reasonableness — Telephone rates in other states.

4. Evidence of telephone rates charged in exchanges outside of the state may not be relied upon in fixing local telephone rates, p. 40.

Rates, § 573 — Telephone — Free interexchange service.

Discussion of a telephone company's plan to provide extended area service to residents of Minneapolis and St. Paul and other local telephone service problems in the Twin Cities area, in view of the closely knit economic and social life in the area, p. 37.

Taxes, § 1 — Federal excise taxes on telephone users.

Discussion of the unfairness and discriminatory nature of federal excise taxes levied on telephone users, in view of the necessity of telephone service, p. 39.

By the COMMISSION: On October 14, 1953, the Northwestern Bell Telephone Company, a corporation, filed with this commission an application for an order establishing fair and reasonable rates and charges for all classes of telephone service furnished by the company within the state of Minnesota. Thereupon the commission issued its order assigning for

hearing before the commission said application at its hearing room, 470 State Office building, Saint Paul, Minnesota, at 9:30 o'clock A.M., on Tuesday, November 17, 1953, and said hearing was continued through November 18, 1953.

APPEARANCES: Tracy J. Peycke, Vice President and General Counsel, Northwestern Bell Telephone Company, Omaha, Nebraska; and Adrian C. Cassidy of Minneapolis, Attorney, for the applicant; J. A. A. Burnquist, Attorney General, and Fred W. Putnam, Special Assistant Attorney General, for the state of Minnesota; Harry E. Weinberg, City Attorney, Duluth, for the city of Duluth; Timothy P. Quinn, Corporation Counsel, Saint Paul, for the city of Saint Paul; John F. Bonner, City Attorney, and Carsten L. Jacobson, Assistant City Attorney, Minneapolis, for the city of Minneapolis; L. J. Covey, Minneapolis, for the Railroad Brotherhoods; A. N. Fancher, for the commission, and L. R. Bitney, for the commission.

The commission, after careful consideration of the evidence adduced at said hearing, together with the law applicable thereto, now makes and files the following findings of fact and order:

Findings of Fact

The Northwestern Bell Telephone Company is a corporation organized under the laws of the state of Iowa and is duly qualified and authorized to transact business in the state of Minnesota.

The commission has made investigations into the operations of the Northwestern Bell Telephone Company in four separate proceedings since 1946; said investigations being made under Dockets M–2828 (1947) 72 PUR NS 86, M–3000 (1948) 75 PUR NS 37, M–3090 (1950) 86 PUR NS 218, and M–3508. In these investigations the commission has gone thoroughly into the operating records of said company including capital investment, revenues, and expenses, and has made a study of the relationship between the American Telephone and Telegraph Company and the Northwestern Bell Telephone Company and the relationship between the Western Electric Company and the Northwestern Bell Telephone Company.

In Docket M–3508 this commission issued its order dated the 16th day of January, 1953, authorizing the present rates now charged by the Northwestern Bell Telephone Company to its subscribers. The company bases its present request for further increases in telephone rates on the fact that on August 16, 1953, after extended negotiations with the labor union representing its employees, said company made a settlement of wage increases thereby increasing its Minnesota intrastate operating costs by $1,453,454 annually. In addition thereto, due to increased costs incurred by connecting companies in originating and terminating long-distance calls, the allocation of revenues derived from these jointly furnished services has increased the intrastate operating costs of the Northwestern Bell Telephone Company by $223,000 per annum. The company further shows that it is expending $17,915,000 for expansion and improvements to its Minnesota plant during 1953. That in spite of the efforts of the company there were on

September 30, 1953, 4,321 unfilled applications for telephone service and more than 26,000 unfilled applications for higher grades of service. Since January 1, 1946, the total investment in plant and equipment in the state of Minnesota has about doubled, to wit from $89,465,000 to $180,622,895 as of September 30, 1953. During this same period the number of telephones in service operated by the Northwestern Bell Telephone Company has increased from 480,508 to 757,140 or an increase of 276,632 phones.

The public's demands for additional telephone service has continuously, during the entire post World War II period, kept ahead of the company's ability to furnish the additional service. Quarterly reports made to this commission under its order in Docket M-3090, *supra,* show unfilled applications for new service amounted to 4,396 as of December 31, 1952, and were reduced to only 4,321 as of September 30, 1953, despite a construction program of $17,915,000 during 1953. Due to the increased cost of construction in this period over prior construction periods, the plant investment per telephone has increased from $186 in 1946 to $238 per telephone as of September 30, 1953, and continues to rise due to substantial construction at present high price levels. To illustrate, during the twelve months ending September 30, 1953, the average plant investment for each telephone gained was $464 compared to an average of $238 for all stations in service as of September 30, 1953.

The company has furnished the commission with full details of its construction program for the period September 30, 1953, to December 31, 1954, as well as its property accounts as of September 30, 1953. Further, the company presented intrastate operating figures for the twelve months ending September 30, 1953, and also showed intrastate operations adjusted to reflect application of the rates granted in February, 1953, on a full year basis as well as application of the 1953 wage and other expense increases on a full year basis.

Rate Base

Witness Wasley in Exhibit 14, at page 1, shows as of September 30, 1953, the data summarized below:

State of Minnesota—Original book cost of plant and equipment	$180,622,895.00
Less—Interstate portion	23,480,976.00
Intrastate original cost of plant and equipment	157,141,919.00
Material and Supplies	1,780,132.00
Working Cash	5,589,460.00
Total Original Cost—Intrastate operations	164,511,511.00
Depreciation Reserve as shown by company books	43,290,426.00
Net Book Value claimed by company	$121,221,085.00

[1] The statistician of the commission has thoroughly checked these accounts and recommends a change in working cash capital. Due to the fact that the company collects substantial sums for service in advance and has an accumulation of tax reserves out of earnings, which it can hold for many months at a time, the commission believes that the working cash capital as allowed, in its previous order, is sufficient. This amounts to $2,771,611 and reduces the investment account as of September 30, 1953, to $118,403,-236. The company has filed, at the direction of the commission, in consid-

erable detail the work to be carried on in the expansion of the plant during the balance of 1953 and for the year 1954. These reports by the company have been made a part of the record in this proceeding. The record shows that the construction program for the period September 30, 1953, to December 31, 1953, amounts to $4,363,000 of which $3,795,000 is applicable to intrastate operations and is now completed. That the company's construction program for the year 1954 is $19,585,000 of which $17,038,000 is applicable to intrastate operations. Company officials have testified and the commission's staff has verified that this construction program has been engineered in detail, and there has actually been contracted for intrastate operations properties in the amount of $5,490,000, with definite installation and completion dates during 1954. There is no doubt that the company can and must carry on its program as scheduled and we are continuing our requirement of quarterly reports as to the amounts expended for construction and improvements and the number of unfilled service applications.

[2] The experience of the years following World War II has clearly demonstrated the need for the large scale construction program carried on by the company to meet the increasing demand for additional telephones by the people of this state and it has further demonstrated that the company's earnings will fall below the rate deemed necessary for it to carry on its business and attract the capital necessary to finance its construction program unless some consideration is given to the increased investment made by the company during the period in which the prescribed rates are to be in effect. This same factor has been widely recognized by other commissions and has been discussed very recently in the 1953 report of the committee on valuation for the National Association of Railroad and Utilities Commissioners. If the company is to earn at the rate of return found reasonable herein, due allowance must be made for the effect of large scale construction on its rate of earnings.

The commission, in arriving at its conclusion as to a reasonable rate base, has taken into consideration the sum of $3,795,000 completed construction for the period September 30, 1953, to December 31, 1953, and the sum of $5,490,000 of contracted construction for 1954 out of a total construction program for 1954 of $17,038,000.

The commission, after giving consideration to the effect of the construction program on the company's operations, finds that the fair value of its Minnesota intrastate properties used and useful is $127,688,236 and will use this amount as a rate base for purposes of this proceeding.

Rate of Return

[3] There is nothing in the record to change the commission's former determination that a return of approximately 6¼ per cent is reasonable. It is therefore found that this return on the rate base, as established above, will produce reasonable earnings on the company's Minnesota intrastate properties.

Revenues and Expenses

The Minnesota intrastate net earnings of the company for the 12-month period ending September 30, 1953, adjusted to reflect the rates authorized by

the commission as of February 1, 1953, in Docket M–3508, and the additional wage and other expense incurred during the year are shown by Exhibit 14 to amount to $6,538,235. The commission disallows the sum of $67,461 appearing in Account 323, Miscellaneous Income Charges, and representing certain contributions and membership dues. We find that the adjusted net intrastate earnings projected on an annual basis as of September 30, 1953, is the sum of $6,569,649 and would produce a return in 1954 of 5.15 per cent on the rate base approved by the commission provided there is no increase in revenue.

The commission has determined that an increase in net earnings is necessary by the sum of $1,467,171 making the net return $8,036,820. This would produce a return of 6.29 per cent on the rate base established by the commission.

Twin Cities Service

During the course of his testimony as to plans for future developments and improvements, the company's vice president, Mr. Lindeman, stated as follows:

"The Twin Cities, as everyone knows, are gradually growing closer and closer together. For some time we have given consideration to service arrangements which would more satisfactorily meet the changing communication needs of the people in the Twin Cities metropolitan area.

"We are presently studying plans about which I am optimistic. I feel that real possibilities exist for improving and expanding our service in the Twin Cities area. This plan would be designed to enlarge service to all users in the Twin Cities area by eliminating the present restrictive intercity toll charge, and, in a sense, consolidate Minneapolis and Saint Paul into a metropolitan service area."

Upon examination by counsel for the commission, Mr. Lindeman further testified that the company had been studying a service plan for quite some time and that the results of these studies would soon be available. In view of this testimony, the company was directed to supply the details of its study as soon as it was completed and these have since been furnished to the commission.

The details submitted by the company provide for elimination of the present toll charge between the cities of Minneapolis and Saint Paul and the introduction of a new Twin Cities service plan. Under this plan the 590 square miles of area presently served by the Minneapolis and Saint Paul exchanges would be divided into two "primary" areas and a number of "suburban" areas.

The two primary areas are those roughly bounded by the city limits of Minneapolis and those bounded by the city limits of Saint Paul. These primary areas include about 88 per cent of the 494,000 telephones served by the Minneapolis and Saint Paul exchanges. Under this plan, subscribers in the two primary areas of Saint Paul and Minneapolis will be able to call and be called by *all* of the telephones in the entire Twin City area presently served by the Minneapolis and Saint Paul central offices.

The remaining outlying territory in the Twin Cities area is divided into suburban areas whose boundaries have been drawn to recognized general com-

munities of interest. Subscribers residing in any of these suburban areas will be able to call, without extra charge, all of the telephones in the two primary areas of Saint Paul and Minneapolis as well as the telephones located in the suburban areas adjacent to the area in which they are located. Calls between telephones located in nonadjacent suburban areas, where there is very slight community of interest, would be charged for on a message unit basis in multiples of 5 cents, depending upon the distance between these areas, with a minimum charge of 10 cents applying, the charge to be applied on a per connection basis with no limitation as to length of conversation. According to company studies this plan will place 99 per cent of the present intercity traffic on a local calling, noncharged basis.

Another feature of this plan is that of establishing a toll measuring point centrally located in each of the areas so that short-haul toll calls between telephones in the Twin Cities area and telephones outside this area will more nearly reflect the actual distance between telephones involved. We regard this as very desirable since telephone users, particularly in outlying sections, now pay for long-distance calls from a toll measuring point located in the Midway section. Such a change as this will reduce the toll charges for most of the calls between each of the suburban areas and near-by towns outside of the metropolitan area with which there is much community of interest. In many instances there will be a further reduction because the 15 per cent federal excise tax will apply rather than the 25 per cent tax. For example, in the specific instance of a toll call between one of the suburban areas and a near-by exchange, between which there is considerable communication, the present cost is 25 cents plus a federal excise tax of 25 per cent or a total of 31 cents. Under this plan, as we have described it, the toll mileage would be reduced to the point that this call would cost 15 cents plus a federal excise tax of 15 per cent, or a total of 17 cents.

The commission has been particularly interested for some time in the local telephone service problems in the Twin Cities area. Our objective has been one of finding the means of eliminating the present restrictive toll charge between the two cities as well as generally increasing the value of service to telephone users in the Twin Cities area. We believe that the economic and social life of the two cities is so closely and extensively allied that communication obstacles should be removed.

The commission is strongly of the opinion that this plan is in the public's interest. We believe the time has arrived for the company to proceed immediately to make the necessary installation to put the service plan into operation. Under these circumstances the commission will order the company to proceed with plans for the consummation of a Twin Cities metropolitan area service plan, as outlined in this order, and to make such service operative prior to December 31, 1954, subject, however, to delays caused by casualties, strikes, war, or other conditions beyond the company's control, and to offer the new service to its customers at the basic monthly rates approved by this order.

We recognize that the company will

be faced with revenue losses and with a substantial amount of new investments but this will be offset in part, at least, by expense savings. We are confident that the company can still earn within the range of a reasonable return. Any sacrifice made by the company will be temporary and fully justified in view of the long-range benefits which will accrue to its operations as well as by the substantial improvement in the value of service and satisfaction to the customers in the Twin Cities area.

Service

As of September 30, 1953, the company had unfilled applications for telephone service of 4,321. There were also on file 26,000 applications for higher grades of service. It is the obligation of the company to furnish service to the public as the public demands it and of the grade of service demanded. The commission, in a previous order, stated:

"The inability of people in this state to get telephone service or the class of service they need is serious since it adversely affects their home lives, business affairs, and state of mind. Adequate telephone service is more essential than ever by reason of national and civil defense. It is the commission's position that it is allowing the company reasonable earnings in this proceeding and that the company must, to the full extent that material and man-power are available, render service to everyone in its territory who desires it. Accordingly, the company is required to make quarterly reports to the commission of the number of unfilled applications for new service and for higher grades of service as well as the amounts expended for expansion and improvement. This is not to say that the company has been delinquent in its obligations. It is the commission's intention, however, to do everything in its power to see that good telephone service is made available to the fullest extent possible."

The company is directed to continue these reports and it is the commission's hope that all of its unfilled applications for new service will be taken care of during the year of 1954.

Federal Excise Taxes

The commission, in its previous orders, has called attention to the heavy excise taxes levied by the federal government on telephone users. We desire again to emphasize that the telephone is an absolute necessity to a great many people and that in spite of that, in many instances, it is carrying a tax that is much larger than the tax levied upon articles that are mere luxuries. Where the commission finds it necessary to increase rates so that the telephone company may carry on its business and furnish the service demanded by the people, at the same time it must increase the tax obligation of every telephone subscriber. The National Association of Railroad and Utilities Commissioners has declared these taxes to be discriminatory against telephone users and grossly unfair.

Rates Authorized

The company has requested rates that would produce additional gross revenue of $3,910,259. In analyzing the figures of the company and applying the rate of return found by the commission as reasonable, it is the

opinion of the commission that the sum of $3,405,000 in additional gross revenues annually will produce a sufficient return to the company. Taxes will absorb $1,898,079 of said amount leaving a balance of $1,506,921. From this balance there will be deducted such items as uncollectibles and licensee fees, leaving a net of $1,467,171 available as an increase to the net return of the company.

Appendix "A," which is attached hereto and made a part hereof [omitted herein], shows the exchange and toll rates approved by the commission. We find that these rates are fair and reasonable and that they will provide the additional revenues allowed. The company shall file with the commission a complete schedule of rates as established by this order and the same shall become effective on billing dates commencing February 1, 1954, provided the same are approved by the staff of the commission prior to that date.

[4] During the course of the proceedings, some question was raised as to the reasonableness of local service rates in Group H which includes the Minneapolis and Saint Paul exchanges. While the commission cannot and has not relied upon evidence of rates charged in exchanges outside the state, it may be a matter of public interest to know that the exchange rates prescribed in this order for Group H are lower than the average of those presently in effect in all the twenty-seven cities in the United States comparable to Minneapolis and Saint Paul. To illustrate, the average business one-party rate existing in these twenty-seven exchanges is $15.21 per month, it is $5.57 per month for residence one-party, $4.55 for residence 2-party, and $3.69 for residence 4-party service. So far as residence service is concerned, the Group H exchange rates are among the lowest rates in the entire country for exchanges of comparable size.

It is therefore concluded:

That the present exchange and toll service rates are not just, fair, and reasonable, and are not sufficient to yield a reasonable return on the fair value of the company's property.

Re Treatment of Federal Income Taxes As Affected by Accelerated Amortization

Opinion No. 264, Docket No. R-126
December 4, 1953

PROCEEDING *to consider rules respecting the treatment of federal income taxes for rate making where a fast tax write-off is permitted by the Internal Revenue Bureau; rules adopted.*

Rates, § 147 — Cost of service — Tax savings.

1. A company obtaining a certificate from the Internal Revenue Bureau, permitting depreciation of defense facilities over a 5-year period instead of the normal life of the property, should not be required to reduce rates during the amortization period because of the substantial reductions in income tax which would result, since Congress did not forgive, but merely deferred, the taxes and did not intend that its "rapid amortization" regulation would result in a cash donation to the particular persons who happened to be customers during the 5-year period, p. 42.

Rates, § 13 — Commission obligations — Recognition of defense certificates.

2. The Federal Power Commission, in determining reasonable rates for companies which have received certificates of necessity from the Internal Revenue Bureau permitting the accelerated amortization of defense facilities, must recognize and accept the certificates which have been issued by the agencies charged with that responsibility, and carry out the intent of Congress in regard to such certificates, p. 43.

Expenses, § 114 — Income taxes — Possibility of future reduction.

3. The Federal Power Commission will not predict or speculate on future income tax reductions in so far as such reductions would bear on the rates of a utility enjoying the benefits of an accelerated amortization certificate issued by the Internal Revenue Bureau, p. 44.

Valuation, § 192.1 — Cash saving from accelerated amortization.

4. A company should be permitted to earn a return on temporary cash savings, accruing during the 5-year period of accelerated depreciation of its facilities, when such savings are invested in used and useful plant, notwithstanding a contention that these savings are equivalent to customer contributions which should be charged to the depreciation reserve and thereby deducted from the company's rate base, since the customers of the utility have not made the cash available and since the deferred taxes are not depreciation and should not arbitrarily be labeled as such in order to prevent a certificate holder from receiving what the government has decided to give it, p. 44.

Commissions, § 17 — Limitations on jurisdiction.

5. The Federal Power Commission is an agency of Congress created to perform legislative functions delegated to it by Congress and is without

power to substitute its judgment for that of Congress or to nullify a clear expression of congressional intent by administrative action, p. 44.

Depreciation, § 26.1 — Annual charge — Effect of accelerated amortization for tax purposes.

6. The annual depreciation charge of a utility, enjoying the advantages of an accelerated amortization certificate issued by the Internal Revenue Bureau, will be related to the service life of the facility being depreciated, since there is no obligation on the part of a regulatory agency or a utility to use the same depreciation methods for rate making as are used for computing income taxes, p. 45.

Expenses, § 114 — Deferred income taxes — Commission action.

Statement that the Federal Power Commission will take all necessary steps to insure that provision is made for meeting the deferred tax liability of a utility enjoying the advantages of accelerated depreciation of defense facilities and to be sure that the deferred taxes are not used directly or indirectly for the payment of dividends but are used for the purpose intended, namely, to aid in the construction of the emergency facilities, p. 45.

(Dory, Commissioner, dissents.)

By the Commission: The commission heretofore issued notice of Proposed Rule Making to consider what rules, if any, should be promulgated with respect to the treatment of federal income taxes for accounting or rate-making purposes, or both, under either the Natural Gas Act or the Federal Power Act, or both, in view of the accelerated amortization of the cost of certain facilities permitted under § 124A of the Internal Revenue Code, 26 USCA § 124A.

Arguments were held on March 18 and on October 16, 1953. This opinion will deal only with the rate-making aspect of the problem, and the accounting phase thereof will be dealt with at a later date. There are a number of natural gas companies which have received certificates of necessity for rapid amortization which are entitled to know how this commission will treat these certificates in making rates. For this reason, this commission is hereby announcing its policies in this regard.

What is said herein will, of course, have equal applicability to the interstate sales for resale of electric public utilities subject to our jurisdiction, where all or a portion of the facilities which produce the energy thus sold have been constructed pursuant to such a certificate. Since these interstate sales for resale of electricity are minor in comparison to the volume of intrastate and retail sales, we recognize that the impact of our policies, enunciated herein, on electric public utilities is negligible, but that fact does not diminish or alter in any way the degree of our responsibility to the customers of the electric industry, and to the industry itself.

Nevertheless we realize that the electric public utilities are governed almost wholly in this regard by state commissions. Twenty of the twenty-one commissions which have acted have adopted positions consistent with the principles we are now enunciating.

[1] The accelerated amortization

authorized by § 124A of the Internal Revenue Code was carried in § 218 of the Revenue Act of 1950. When the Senate Committee on Finance reported the bill, it recommended the insertion of § 218 in the House bill, which did not contain a similar provision. Section 124A was said by the Senate Committee to have the same basic objectives as § 124 of the Code which related to the amortization of emergency facilities during World War II. The former § 124 of the Code having been made applicable to certified emergency facilities constructed by utility companies, as well as others, and the new § 124A having the same jurisdictional language and the same basic objectives, the new section, of course, is applicable to electric public utilities and natural gas companies and we have no alternative but to construe it so. In fact, no one who argued before us disputed this point.

Under the accelerated amortization provision of § 124A, any taxpayer who has received a certificate of necessity issued by the proper defense agency for the construction of an emergency facility may elect to take a deduction from gross income over a period of sixty months for the amortization of a specified percentage of the cost of such emergency facilities in lieu of equal annual deductions for exhaustion, wear and tear, and obsolescence during the estimated life of the facilities. Congress sought by this accelerated amortization provision to encourage the construction with private capital of those facilities which were deemed of sufficient value to the national defense to warrant the issuance of a certificate of necessity.

Thus, the recipient of a certificate of necessity obtains substantial deductions against net income for income tax purposes during each of the first five years, and much smaller deductions therefrom during the remainder of the normal amortization period. If the income tax rates remained the same during the entire life of the facilities, the same amount of taxes ultimately would be paid under either accelerated or normal amortization. By the enactment of this law, Congress did not forgive the payment of any income taxes; it merely allowed payment of some of them to be deferred. This has the precise effect of a grant by our government to a certificate holder of an interest-free loan.

Although all parties concede that certificates of necessity issued to electric public utilities and natural gas companies are perfectly valid and lawful, it has been strenuously argued that this commission should nullify them by reducing the rates of such companies during the 5-year period of rapid amortization and thereby pass on to the customers of such companies the money which otherwise would inure to these companies by reason of their being permitted to defer payment of a portion of their income taxes.

The answer to this contention is that Congress obviously did not intend to make cash donations to the particular persons who happen to be, during the 5-year period of accelerated amortization, the customers of the particular utilities which have received certificates of necessity. Such a result would be inconsistent with the effort of Congress to aid our national defense.

[2] It has been argued that some certificates were improvidently issued,

and that we should for that reason prevent the holders thereof from receiving any benefit therefrom. While we have some question regarding the issuance of such certificates for property obviously having long-term usefulness, nevertheless we cannot usurp the authority or veto the acts of another agency of the government. We accept the responsibility to abide by § 124A of the Internal Revenue Code and will, to the best of our ability, carry out the intent of Congress in our treatment of certificates of necessity issued thereunder. We have not been given, and consequently cannot accept, any authority or responsibility for the issuance of any such certificates of necessity, and must recognize and accept those which have been issued by the agencies charged with that responsibility.

[3] Another contention which has been made is that income tax rates probably will be reduced in the future, and consequently certificate holders will receive an undue advantage by having unusually large deductions from income taxes during a period of high taxes, which will not be fully offset by the smaller subsequent deductions, if taxes are then lower. We cannot predict and should not speculate on future income tax rates. Congress undoubtedly was aware of the possibility of income taxes being reduced. Nevertheless it enacted this legislation. We have no power to enact different legislation.

[4] Still another contention which was advanced was that the amount of temporary cash savings which would accrue during the 5-year period of accelerated amortization should be charged to the depreciation reserve and thereby deducted from the rate base of the utility on the theory that it is equivalent to customers' contributions, and therefore the utility should not be allowed to earn on these amounts.

This argument is fallacious. The particular customers of a particular utility have not made this cash temporarily available to the utility.

The customers are not called upon to do anything more or different than they are now doing. They will pay the same rates, no more, no less. They neither lend nor give their money to the utility. Their position is the same with accelerated amortization as it is without it. It is the other two parties to the transaction who change their position—the United States Government and the utility. The United States Treasury will not receive, in the 5-year period, money which it otherwise would have received, and the utility will have the money which the Treasury does not have during that period. Thereafter, the utility starts paying the money back to the Treasury. No contribution is made by the customers or by anyone else.

The proposal to charge the temporary tax savings, during the 5-year period, to the depreciation reserve is clearly a device to reach a compromise, which will allow the certificate holder to receive some but not all the benefits Congress intended. Deferred taxes are not depreciation and should not arbitrarily be labeled as such in order to prevent a certificate holder from receiving what our government has given him.

[5] This commission is an agency of Congress created to perform certain legislative functions which Con-

gress has delegated to us. We have a legal and moral obligation to abide by and execute the laws of Congress. This obligation does not permit us to substitute our judgment for that of the Congress or nullify the clear congressional intent by administrative action.

Much has been said concerning the extent of the benefits conferred by the issuance of these certificates and the advantages of the use of money without payment of interest thereon. This is wholly immaterial to the question now before the commission. The law and the principle involved is the same whether one certificate for a small amount has been issued, or whether a thousand certificates for large amounts have been issued.

In a number of cases, the investment made by a certificate holder in reliance on his certificate has been a major fraction of his previous total investment. All the plans suggested in these hearings to deprive the certificate holder of the benefit of his certificate would in some cases very probably place the certificate holder in a position where he could not meet his current obligations to creditors or shareholders. Such an eventuality would result either in serious impairment or abandonment of service and would not be in the public interest.

[6] It appears essential to continue the depreciation policies which we have heretofore followed; namely, to relate the annual depreciation charge to the service life of the facility being depreciated. As applied to an emergency facility subject in whole or in part to accelerated amortization, the fact that temporary tax savings may be realized by the company through § 124A should not affect the annual charge for depreciation for rate-making purposes.

Not infrequently, the depreciation methods allowed and recognized by a regulatory agency are not the same as those used by the utility for computing income taxes. We will recognize normal depreciation where a public utility or natural gas company has the privilege of accelerated amortization under § 124A of the Internal Revenue Code. We will use all safeguards at our command to insure that the ratepayer is protected from bearing any burden greater than normal depreciation after the period of accelerated amortization has expired. It has been contended that this is a difficult task and creates an unwieldy situation. Even if this were true, it is no reason to refuse to perform the duty.

While it is clear to us that Congress, by the enactment of this law, did not intend to make gifts to the customers of the public utilities and natural gas companies which received certificates, it is equally clear that Congress did not intend to provide a temporary fund to these companies which could be diverted to the payment of dividends to their shareholders. Since the possession of necessity certificates is essentially a deferment of tax liability, the accruals for taxes in excess of those actually paid should logically be treated, not as free and unrestricted income, but earmarked to provide for the future meeting of such liability.

Consequently, we will take all steps necessary to insure that provision is made for meeting the deferred tax liability and the temporary savings produced by the deferral of taxes are not used, directly or indirectly, for

the payment of dividends, but are used for the purpose intended; namely, to aid in the construction of the facilities described in the certificate which were deemed by our government to be necessary to the national defense.

We will treat accelerated amortization in accordance with the principles stated herein, in rate cases which come to us which have that factor in them. As stated above, the accounting treatment will be dealt with later.

DOTY, Commissioner, dissenting: I dissent from the action of my associates in their decision in the above-mentioned docket. In my opinion the decision will require ratepayers to pay far more than a fair return for utility services, contrary to a long line of precedents established by this commission which have been upheld by the courts. The decision will give utilities returns in excess of those necessary to render adequate service and to attract capital for proper expansion of facilities; it will impose unjust burdens on consumers equal to these excessive returns; it will unnecessarily complicate the regulatory process.

The Problem

Congress, during World War II and the present cold war period, authorized special income tax deductions with respect to emergency facilities. The present law, § 124A of the Internal Revenue Code (Revenue Act of 1950), is patterned after former § 124 (Revenue Act of 1940)—so much so that we must look to the latter for the legislative history of the former.

Under the law, specified agencies of the federal government are empowered to issue certificates of necessity authorizing the cost, or a certain proportion of the cost,[1] of emergency facilities to be taken as an income tax deduction over a period of sixty months, even though such facilities have a much longer service life when acquired for normal peacetime pursuits.

It is evident that many of the utility facilities certificated will have a life in service considerably beyond the sixty months' amortization period. For example, some facilities licensed by this commission and for which accelerated amortization certificates have been issued will probably give service in the neighborhood of 100 years. By accelerating the depreciation deduction consequential savings in taxes will be realized in the amortization period.

After the amortization period has ended, the accelerated depreciation deduction will cease for tax purposes. Inasmuch as under the tax laws only 100 per cent of the cost of depreciable property may ultimately be recovered as depreciation expense, it is likely that annual depreciation expense subsequent to the amortization period, will be less than that normally allowable because of the previous acceleration as to part of the cost.

The conflict between accelerated depreciation and normal depreciation, with attendant tax savings in the amortization period, has created a very serious regulatory problem. The majority of the commission seek to solve this problem by permitting the recovery from ratepayers in the amortization period of amounts which

[1] It appears that about 45 per cent of total cost of emergency facilities of gas and electric companies has been certified for allowance as accelerated depreciation.

would have been payable as income taxes had the special accelerated depreciation deduction not been allowed. In other words, they would not, in fixing rates, give effect to the tax savings during this period, but, rather, would treat such tax savings as tax expense, with offsetting credits to some kind of a special reserve. In the post-amortization period they probably would not allow the actual income taxes payable on the business for each year, but instead would allow only the actual taxes reduced by a credit resulting from the allowance of more than actual taxes in the prior amortization period.

The amounts which the utility will thus collect under the guise of taxes payable to the government over some 25 to 100 years after the close of the amortization period will be available to the utility for its ordinary capital needs. The amount recouped as taxes will be substantially in excess of the actual taxes payable for a long period in the future and the excess could be used to pay off pro tanto securities issued to finance the emergency facilities or to purchase other facilities, the cost of which would then be included in the rate base. Unfortunately, under the decision of the majority in this case, the consumers will not in any manner whatsoever receive any credit for these large payments which, as noted above, can readily be used for capital purposes.

The majority base their conclusions on what they believe to be the intention of Congress. In my opinion they have seriously misinterpreted that intention.

The general intention of Congress, as I will later show, was to allow rapid recovery of the investment or part thereof in facilities which have a doubtful economic life at the end of the emergency period. The intention of Congress, therefore, may best be carried out if we recognized accelerated depreciation in the fixing of rates. This would permit, at least in part, the rapid recovery of the investment.[2]

It is well established that when utility customers pay for the cost of plant, which they do through the depreciation allowance, they are given credit for such payments through the deduction of the resulting depreciation reserve in the computation of the rate base. The Federal Power Commission was successful in having the Supreme Court of the United States approve this principle in the Hope Case.[3]

As to the amount of accelerated depreciation to be allowed in rate cases, at the present time I would allow an amount equal to the tax savings in the amortization period which is all that is claimed as additional expense at this time. I would not close my eyes, however, to claims for larger amounts upon a proper presentation as to probable economic loss during the amortization period.

Legislative History

The legislative history of § 124A of the Internal Revenue Code, 26 USCA § 124A, is meager; we must look to its predecessor, § 124 (2d Revenue

[2] This would also avoid the sudden changes in rates consistent with the aims of those who advocate "normalizing" income taxes. During the amortization period depreciation expense would be increased whereas taxes would decrease. In the post-amortization period income taxes would presumably increase whereas depreciation expense would decrease because of cessation of accelerated depreciation.

[3] Federal Power Commission v. Hope Nat. Gas Co. (1944) 320 US 591, 88 L ed 333, 51 PUR NS 193, 64 S Ct 281.

Act of 1940), to ascertain its purposes. The then Assistant Secretary of the Treasury, Mr. John L. Sullivan, testified in support of the original measure as follows:

"The agencies of the government charged with the duty of letting contracts for national defense orders have brought to the attention of the Treasury an aspect of the present income tax law on which they have requested revision. I refer to the provisions for depreciation . . . . Under the existing law the taxpayer is permitted to spread the cost of his depreciable assets over their expected life . . . . [However] . . . in those cases in which the plant and equipment will have little or no use after the completion of the defense program, the rate of depreciation must be increased if the manufacturer is to have the opportunity of charging the cost against income during the period of emergency. Such accelerated depreciation or amortization cannot be allowed under existing law. The advisory commission to the council on national defense, and the War and Navy Departments, have informed the Treasury Department that the inability of manufacturers to secure special amortization allowance is impeding the letting of defense contracts. Because of this situation the Treasury recommended to the subcommittee that provision be made by law for special amortization of the cost of new plant and equipment necessary to the defense program over a period of five years, . . ."[4]

The position of the industry as was well explained by the Boston Chamber of Commerce:

"It is therefore universally recognized that there must be some means provided by which the cost of the expansion of plants for defense purposes may be deducted from gross income for tax purposes if the facilities thus provided cease to be useful when the present emergency passes. The best method is to allow a deduction from gross income similar to the deduction now allowed for depreciation, obsolescence, or destruction by flood, fire, or other calamity of capital assets, under the heading of amortization of defense facilities."[5]

Thus it was recognized that defense facilities might cease to have usefulness or at least experience diminished usefulness at the end of the emergency period, hence it was necessary, in order to attract capital, to permit the rapid recovery of the investment, or a substantial part thereof, during such emergency period.

This is made abundantly clear by the Committee on Expenditures in the Executive Departments in a report to Congress in 1951:

"When it is said that certificates of necessity were intended as an 'incentive' to private capital to build defense plants, all that properly means is that private enterprise would naturally be reluctant to invest in a war or emergency facility unless assured by a certificate of necessity that cognizance will be accorded by the government to the probability that the facility will have a comparatively short economic life."[6]

And—

"This subcommittee believes the

[4] Joint Hearings, Committee on Ways and Means, H. of Rep. and Senate Committee on Finance, 76th Cong. 3rd Sess.

[5] Joint Hearings, *supra*, p. 477.

[6] House Report 504, 82nd Cong. 1st Sess. p. 17.

major factors controlling the percentage of the certificate should be the proper economic usefulness of the facility for other than defense purposes after five years . . . ."[7]

The testimony of officials charged with the responsibility of issuing certificates of necessity shows that they considered accelerated depreciation allowances as their best estimates of the economic depreciation which would likely occur during the emergency period:

"I should say that it is largely the control; namely, what is in our best judgment or estimate of the profitable usefulness of the facility after the emergency period. I do appreciate that it is impossible to do that with mathematical precision."[8]

. . . . . .

"Mr. Casey: Is it not true that certificates of necessity were originally designed to cover the economic depreciation of the facility during the 5-year period as distinguished from physical depreciation?

"Mr. Creedon: I believe that is correct, yes sir."[9]

. . . . . .

"Mr. Casey: In other words, under the practice and procedure at present where a percentage is fixed in the amount of 85 per cent for a steel company, that logically should represent a determination in advance and as correctly as possible under the circumstances that the facility will be 85 per cent depreciated economically at the end of the 5-year period?

"Mr. Kirby: Yes; that is right."[10]

Therefore, the basic purpose of accelerated depreciation is to permit the rapid recovery, in whole or in part, of investments which might be in jeopardy (and, therefore, unattractive to investors) under normal depreciation practices.

I accept without qualification the purpose of § 124A as shown by the legislative history. I accept, of course, the action of the appropriate defense agency officials in issuing certificates of necessity to companies subject to this commission's jurisdiction. I agree with my associates that it is not for this commission to inquire into the reasonableness of their action. Our job, as far as is pertinent here, is the regulation of public utility rates—we take over in this matter where the defense agencies leave off.

Treatment of Accelerated Depreciation In Rate Cases

In the treatment of accelerated depreciation for rate-making purposes, we start with the knowledge that duly constituted agencies of the federal government have found that certain facilities are so closely identified with the national emergency as to require special depreciation allowances. I would, therefore, allow accelerated depreciation (in the amount of tax savings) in the computation of rates as well as for the purpose of accounting.

My associates apparently would not allow additional depreciation expense but instead would adjust the actual income tax expense upward by the

[7] House Report, *supra*, p. 3.

[8] Hearings into the Policies, Procedures, and Program Involving Granting of Certificates of Necessity and Loans, 82nd Congress, 1st Session, p. 301, testimony of Frank H. Creedon, Assistant Administrator, Facilities Construction Bureau, National Production Authority.

[9] *Supra*, pp. 301, 302. Mr. Casey was Counsel for the Subcommittee.

[10] *Supra*, p. 341, Vance N. Kirby, Tax Legislative Counsel, Treasury Department.

amount of the tax savings due to the allowance of accelerated depreciation for income tax purposes. In the post-amortization period, I presume income taxes would be adjusted downward. In other words, they reverse the process; they deny accelerated depreciation and proclaim accelerated taxes.

This procedure is erroneous, in my opinion, in at least four respects: (1) it does not conform to congressional intent, i.e., the allowance of accelerated depreciation; (2) it results in overstatement of income taxes for five years and understatement of such taxes for many years thereafter; (3) it is unwieldy; and (4) it fails completely to compensate the ratepayer for his contribution to the capital of the utility.

I have already discussed (1) above. As to the second point, the allowance of more income taxes than are legally due on the income for the 60-month period—more taxes than are lawfully accessible—is not sound. This commission has held on several occasions that it will allow only actual taxes in the computation of rates and the present decision is, therefore, a departure from well-reasoned precedent.[11]

True, my associates imply that they will offset the allowance of more than actual taxes during the 5-year amortization period by the allowance of less than actual taxes during the post-emergency period. Of course, this proposal involves a great deal of speculation. Questions of future tax structure and tax rates affect the equities of the proposition. Moreover, the allowance of less than actual taxes, even though to offset excessive allowances in previous years, is a poor regulatory device. A large element of confusion is unnecessarily introduced into regulation by this approach including, among other things, the question of law as to the authority to require a utility to charge rates which will not allow full recovery of actual taxes.

The method sanctioned by my associates is unwieldy at best. If the tax credits are to be made over the remaining life of the property, then tax adjustments in the case of some hydroelectric projects will be made for 100 years. Of course, the adjustments will never be made for this long period—the proposal will be abandoned because of its impracticality long before the end of the service life of the property. On the other hand, if a rough period of, say, twenty-five to thirty years is taken as the period during which tax credits must be imposed, this is an arbitrary determination resting solely on expediency, which likewise is a poor regulatory standard. This latter procedure departs from the "deferred tax" theory and is plain recognition of the impracticalities of that theory.

The annual upward adjustment of income taxes during the accelerated depreciation period will be large and the annual credits during the much longer succeeding period will be much smaller. The net effect of this will likely be that consumers will stand the large bookkeeping increases in expense with little chance of getting any of the benefit from the small bookkeeping reductions thereafter.

More important, however, is that

[11] Re United Fuel Gas Co. Docket Nos. G-1781, G-2055, Opinion No. 258-A, issued November 19, 1953 [modification of Opinion No. 258, August 7, 1953, 100 PUR NS 405]: Re Transcontinental Gas Pipe Line Corp., Docket No. G-1842, Opinion No. 227, issued May 29, 1952, 94 PUR NS 333.

the method proposed by my associates fails to give the ratepayers any credit for their payment of hundreds of millions of dollars many years in advance of the time when such amounts are theoretically due as taxes. Thus under their method ratepayers in 1954 will be charged for amounts earmarked as income taxes due as late as 1984 or 2004. Even if such amounts were actually prepayments of taxes, the ratepayer should be compensated for the use of this money by the utility for such a long period of time.

The method I advocate automatically eliminates any such inequities as the foregoing. The same dollars would be collected from ratepayers initially, but the extra amounts would be treated as additional depreciation expense in accordance with the underlying theory of accelerated depreciation. These dollars could be used to pay off the capital invested in the facilities or invested in new facilities. As the amounts are collected from the ratepayer, the investment on which the ratepayer pays a return would be correspondingly reduced. It has been the standard practice of this commission almost since the inception of its rate regulatory authority to reduce the investment base by the depreciation allowance. Thus the commission said in the Safe Harbor Water Power Corporation Case:

"There is no principle or concept of regulation, either in law or in fact, requiring consumers to pay in perpetuity a return on the total capital initially embarked in the enterprise when such capital is periodically returned through depreciation charges and in the absence of reinvestment of such capital in the utility's operative property. Such return of capital terminates the consumers' obligation."[12]

The decision of the commission in that case was upheld by the United States court of appeals for the third circuit[13] and certiorari was denied by the Supreme Court of the United States.[14]

It is interesting to note that since the decision of the Supreme Court in the Hope Case, *supra*, most regulatory commissions deduct the depreciation reserve or its equivalent in the computation of the rate base.[15]

The recognition of accelerated depreciation would accomplish the purpose of § 124A of the Internal Revenue Code in that it would permit the rapid recovery, at least in part, of capital invested in emergency facilities. This may be shown by the illustration below in which the following assumptions have been made:

(a) Gross investment $1,000,000, of which 60 per cent has been approved as subject to accelerated depreciation;

(b) Normal service life, forty years;

(c) Rate of return, 6 per cent.

Thus the foregoing illustration shows that under the method I propose the utility would get back $398,000 as depreciation expense in the amortization period. This would permit the utility to pay off that amount of securities and to reduce its capital obli-

[12] (1946) 5 FPC 221, 254, 66 PUR NS 212, 243.

[13] (CA3d 1949) 84 PUR NS 344, 179 F2d 179.

[14] (1950) 339 US 957, 94 L ed 1368, 70 S Ct 980.

[15] State Commission Jurisdiction and Regulation of Electric and Gas Utilities, 1948, Federal Power Commission, p. 8.

	Net Investment at End of 5 Years	
	Normal Depreciation	Accelerated Depreciation
Gross Investment	$1,000,000	$1,000,000
Depreciation at 2½% for 5 years	(125,000)	(125,000)
Acceleration of Depreciation (tax savings associated with $600,000 at 52% tax rate)	.....	(273,000)
Net Investment	$875,000	$602,000

gation to $602,000 at the end of that time. Obviously it would then need a fair return on only $602,000 to be saved whole and any larger allowance would constitute an additional benefit to the company.

Under the rule announced by the majority the ratepayer would pay the same $398,000 but only $125,000 would be classified as depreciation, the balance of $273,000 being classified in some special reserve. This latter amount could be used to reduce capital obligations or to finance expansions just as the higher allowance for depreciation could be used. However, the majority would give the ratepayers no credit for this advancement of capital.

When we remember that certificates of necessity have been issued to electric and gas utilities providing for accelerated amortization of some two billion dollars,[16] the extent of the benefit may be imagined. Suffice it to say that on the basis of a 6 per cent return and an average life of forty years, the additional income to the utility in excess of a fair return over the life of the property would amount to about $491,000 for every million dollars of investment subject to accelerated depreciation.

The legislative history shows that it was the intention not to create such a benefit through enaction of § 124A. There is not a shred of evidence to the effect that utilities were to receive more than a fair return by the operation of that section.

It has been stated that the income tax saving in the amortization period is in effect an interest-free loan from the government. I do not so construe it. The actual dollars come from customers. The amount has none of the characteristics of a loan—due date, amount certain, etc. The collection of additional taxes commensurate with the savings is somewhat speculative, depending upon tax rates and tax structures many years in the future. The government in the past has made many loans to assist defense industries but the instant amounts are not in this category.

Upon a decision[17] of the supreme court of Pennsylvania, prepayments of income taxes for one year are considered advances of working capital. The court held it was arbitrary and unreasonable not to deduct the amounts thereof in computing the working capital element of the rate base. This principle of law would seem to require the deduction from the plant element of the rate base, the larger "prepayments" required by my associates in this proceeding.

To me, the problem would best be handled by the allowance of accelerated depreciation expense and the deduction of the resulting depreciation reserve from the rate base in the fixing of

[16] Only a small part of this total is involved in rates subject to this commission's jurisdiction.

[17] Pittsburgh v. Public Utility Commission (1952) 370 Pa 305, 94 PUR NS 353, 88 A2d 59.

just and reasonable rates. This allowance, in my opinion, would conform to the principle of the Internal Revenue Code, it would permit rapid recovery of investment in defense facilities, it would treat ratepayers and the utilities fairly, and it would avoid the messy accounting which, I am sure, will ultimately be abandoned in the plan approved by the majority of this commission.

It has been said that the charging of tax savings as additional depreciation expense would interfere with the orderly calculation of depreciation. I do not agree with this view. First of all, to the extent that the defense facilities have a shorter than normal economic life, this fact must be allowed for. Secondly, we know that the depreciation expense at best is an estimate. We know that the reserves on the books frequently do not match the thoretically proper reserves. We know, too, that only the full cost of depreciable property should be recovered as depreciation expense. Studies from time to time are necessary to accomplish this end. Changes in rates from time to time are necessary under any depreciation method. Studies of the remaining service life where accelerated depreciation is allowed must be made for income tax purposes. Little or no additional studies would be necessary for the purposes of regulation.

Finally, the method of spreading the net investment in plant at any given time over the remaining life is an approved procedure where sound depreciation practices have been observed. This commission has been using this method with respect to depletion allowances for a great many years. The committee on depreciation of the National Association of Railroad and Utilities Commissioners fully supports this application of the straight-line method. In that committee's report for 1950 it says:

"The aim of depreciation accounting is to spread the cost of plant, less net salvage to be realized on retirement, as equitably as is practicable over the service life of the plant. This aim is difficult of precise achievement because the factors upon which depreciation charges are based will not be definitely known until the plant has been retired. During the time plant is in service, its average service life, the salvage expected to be realized, and the cost of removal expected to be incurred are necessarily estimates. These estimates are subject to change from time to time as more comprehensive information regarding past experience and probable future conditions become available. Nevertheless, it is not likely that the exact amount of depreciation expense charges required will have been provided unless a procedure is established for reconciliation of the estimates of depreciation accruals with the actualities which develop as the years pass by.

"Such reconciliation can be made by application of the remaining life basis of depreciation accounting. Under this procedure, the cost of plant, less net salvage, and less depreciation already provided for, is spread over the remaining service life of the plant. In other words, the undepreciated cost is to be provided during the remaining period of service of the plant. As plant becomes older, estimates of its total service life and remaining service

life become more accurate, and final net salvage may be estimated more closely. Thus, the remaining life basis for all practical purposes assures that the actual cost of depreciation will be charged during the life of plant."[18]

For the reasons stated I dissent from the action of the majority in this proceeding.

[18] Proceedings of the 62nd Annual Convention of the National Association of Railroad and Utilities Commissioners, Report of the Committee on Depreciation, p. 242.

ARIZONA SUPREME COURT

General Alarm, Inc.

v.

Joe B. Underdown et al.

No. 5692
— Ariz —, 262 P2d 671
November 2, 1953

APPEAL *from decision granting motion to dismiss proceeding to enjoin operation of emergency signal and alarm system business without certificate of convenience and necessity; affirmed.*

Public utilities, § 12 — Tests of public utility character.

1. To be a public service corporation a company's business must be such as to make rates, charges, and methods of operation a matter of public concern, and it must be clothed with a public interest to the extent clearly contemplated by the law which subjects it to government control, p. 56.

Public utilities, § 69 — Emergency signal and alarm system — Protective services.

2. A company operating an emergency signal and alarm system for transmission of emergency messages through its equipment to a central office for conveyance to public officials is not in the business of sending messages to the public but is essentially in a business of property protection for the benefit of individual property owners and is not a public service company subject to governmental control and requiring a certificate of convenience and necessity, p. 56.

APPEARANCES: Yale McFate, Phoenix, for appellant; Eli Gorodezky and Walter P. Boyd, Phoenix, for appellees.

WINDES, J.: Complaint was filed by appellant General Alarm, Inc., a corporation, herein designated plaintiff, against appellees Joe B. Underdown and Glen D. McMurtry, herein designated defendants. Defendants moved for dismissal upon the ground that the complaint failed to state a claim upon which relief could be grant-

ed. The motion to dismiss was allowed and final judgment entered for the defendants. Plaintiff appeals and assigns as error the dismissal of the complaint, for the asserted reason that the facts stated in the complaint were sufficient to show plaintiff to be a public service corporation and entitled to the relief sought.

The allegations of the complaint which are essential to test the ruling of the trial court are substantially as follows: That plaintiff is an Arizona corporation and under its articles of incorporation is authorized to act as a public service corporation; that pursuant to the application of one R. L. Wilson, the Arizona Corporation Commission, on May 9, 1950, entered an order finding that the public convenience and necessity required the installation, maintenance and operation of a burglary, fire, and emergency signal and alarm system within a radius of 25 miles from the cities of Phoenix and Tucson and granted applicant a certificate of public convenience and necessity authorizing the transmission of messages over, through, or in connection with the operation of a signal and alarm system; that the corporation commission on February 23, 1951, authorized the transfer of said certificate to the plaintiff, and the plaintiff has succeeded to all rights thereunder and is operating said business. It is further alleged that Wilson expended large sums of money and much labor in the construction of the signal and alarm system, secured subscribers to the service, and at all times held himself out as ready and willing to serve all applicants without discrimination at rates on file with the corporation commission; that after plaintiff's system was installed the defendants proceeded, without a certificate of convenience and necessity from the Arizona Corporation Commission, to install a similar alarm system in Phoenix and are operating in competition with the plaintiff and serving some of plaintiff's customers. The complaint prays that the defendants be enjoined from operating any signal and alarm system which incorporates as an integral part thereof the transmission of messages and be enjoined from the transmission of messages over, through, or in connection with the operation of a signal and alarm system. The nature of the operation of the system is stated in the complaint in the following language:

". . . the transmission of emergency messages by use of central office equipment and connecting wires and electric and electronic equipment. That in the normal operation of said business, telephonic and electrically coded telegraphic messages are transmitted by wires and other equipment under the control of the central office, from the customer's residence or place of business to such central office, where such messages are relayed by direct telephone or coded telegraphic means, over similar transmission lines to the fire department, sheriff's office, city police department, or other governmental agency."

It is clear that if the business and the methods employed in the operation thereof as described in the complaint places it in the category of a public service corporation requiring a certificate of convenience and necessity, thereby putting it under the supervision and control of the corporation commission, the court erred in dismissing the complaint. Likewise, if

such business and its methods of operation do not so classify it, free competition cannot be interfered with and the plaintiff would have no cause of action. The correct answer to the problem thus posed is dependent upon the proper construction of §§ 2 and 10, Art 15, Constitution of Arizona, which so far as applicable are as follows:

"All corporations other than municipal engaged in . . . transmitting messages or furnishing public telegraph or telephone service, . . . , shall be deemed public service corporations." Section 2.

". . . all . . . transmission, telegraph, telephone, . . . corporations, for the transportation of persons, or of electricity, messages, water, oil, or other property for profit, are declared to be common carriers and subject to control by law." Section 10.

[1] To be a public service corporation, its business and activities must be such as to make its rates, charges, and methods of operation a matter of public concern. It must be, as the courts express it, clothed with a public interest to the extent clearly contemplated by the law which subjects it to governmental control. Free enterprise and competition is the general rule. Governmental control and legalized monopolies are the exception and are authorized under our Constitution only for that class of business that might be characterized as a public service enterprise. The theory is that the right to public regulation and protection outweighs the customary right of competition. If the public contact with a business is such that its necessities and convenience can be better served through governmental supervision and controlled monopoly, thereby eliminating customary competition, the state may exercise its police power to that end. Such invasion of private right cannot be allowed by implication or strained construction. It was never contemplated that the definition of public service corporations as defined by our Constitution be so elastic as to fan out and include businesses in which the public might be incidentally interested or businesses that might incidentally transmit messages in furtherance of the main object of the enterprise that otherwise could not be so characterized. The public has some interest in all business establishments but that interest must be of such a nature that competition might lead to abuses detrimental to the public interest. The public interest contemplated depends on the nature of the business, the means by which it touches the public, and the abuses which may reasonably be anticipated if not controlled. Wolff Packing Co. v. Court of Industrial Relations, 262 US 522, 67 L ed 1103, PUR1923D 746, 43 S Ct 630, 27 ALR 1280. Our Constitution must and easily can be interpreted in harmony with these principles. So construed, it is only in the interest of the convenience and necessity of the public, of the nature and to the degree herein stated, that a business may be supervised and controlled, rates fixed or monopolies granted.

[2] Our view is that the plaintiff cannot qualify as a public service corporation. The Constitution says it must be engaged in sending messages. Necessarily, this means it must be in the *business* of sending messages for the *public*. Plaintiff's business cannot within reason be said to be that of

sending messages for the public generally or any substantial segment thereof. Its business is essentially that of property protection. Through means of the installations described, it receives or you might say sends to itself information which in turn it, by means of telephone or otherwise, conveys to the public officials. It is essentially a mechanical watchman. The relaying of the information which it gains electrically or mechanically is not different from messages any watchman might relay over the telephone or otherwise to the police station. One is no more a public service than the other. Certainly the public is interested in the protection of property but these services are not performed or the benefit of the public but for the benefit of the individual property owners. The transmission of the information is merely incidental to the operation of the plaintiff's main business—property protection.

A similar question was presented to the appellate division of the supreme court of New York in the case of Holmes Electric Protective Co. v. McGoldrick (1941) 262 App Div 514, 30 NYS2d 589, 592. Therein a statute imposed an excise tax on utilities, and utility was defined as any person subject to the supervision of the department of public service or engaged in the business of furnishing or selling electric, telephone, or telegraph service. The state public service commission had theretofore decided it had no jurisdiction and the court held that the company was not engaged in the business of selling electrical, telephone, or telegraph service but was engaged in the business of protecting the customer's property. The court said:

"Analysis of the testimony adduced and of the various types of contract between petitioner and its customers establishes, in our opinion, that petitioner during the taxable period was not engaged in the sale of electric, telephone or telegraph service within the meaning of the tax laws. The electric signals transmitted over petitioner's wires are only incidental to the ultimate contractual purpose between petitioner and its customers, namely, protection of the customer's premises from unauthorized entry. What the customer buys and pays for is not a telegraph service. That consists essentially in the mere transmission of communications, the service of the telegraph company being completed when the message has been transmitted. Petitioner's customers were purchasing and petitioner was selling what began when the electric signals were transmitted, namely, some form of protection of the customers' premises.

"Railroad and subway companies use electric signal systems to provide safe operation of their trains. Obviously, such companies are not engaged in telegraphic service for their customers, as such term is ordinarily understood. The customers of such companies are buying and the company is selling transportation. Here the customers are buying not telegraphic service as it is ordinarily understood but protection of their premises."

By legitimate analogy, plaintiff's customers are not buying messenger service but protection of their premises.

Plaintiff leans heavily on the majority opinion in Holmes Electric Protective Co. v. Williams, 228 NY 407, PUR1920E 75, 127 NE 315. The question presented there is not the

same as that presented here. This case is distinguished in Holmes Electric Protective Co. v. McGoldrick, *supra*, and we think it is equally distinguishable here.

The judgment is affirmed.

Stanford, CJ., and Phelps, La Prade, and Udall, JJ., concurring.

NEW JERSEY BOARD OF PUBLIC UTILITY COMMISSIONERS

Re Commonwealth Water Company

Docket No. 7638
January 6, 1954

APPLICATION *by water company for authority to issue bonds, preferred stock, and common stock in exchange for outstanding common capital stock; granted.*

Security issues, § 82 — Exchange of common stock — Preservation of voting control.

1. A water company, being authorized to issue bonds and preferred stock, was also authorized to issue common stock in exchange for outstanding common stock on a four-for-one basis, where the quadrupling of the voting power of the corporate holder of the common stock would assure continued control by the parent company, p. 59.

Security issues, § 99 — Debt securities — Debt ratio.

2. The issuance of debt securities was approved as being reasonable, although it would result in a debt capital ratio of 63.9 per cent as against the board's policy normally of an allowable maximum debt capital of no more than 60 per cent, where there were three classes of securities, where the company's financial position was sound and its earning capacity was more than ample to cover the carrying charges of its debt, as well as its required dividends on its preferred stock, where a considerable increase in the company's earning capacity was expected to result from the new construction presently planned and in progress, and where the increase in equity capital resulting from the financing would gradually reduce the ratio of debt capital, p. 59.

Security issues, § 5 — Redemption provisions.

3. Provisions in bonds and preferred stocks precluding redemption during the first five years were considered reasonable and in the public interest, since they protected the holders against any effectual reduction of the interest rate during that period, p. 60.

By the BOARD: Commonwealth Water Company, a public utility of New Jersey, by application dated August 14, 1953, as amended December 2, 1953, and further amended at public hearing held on December 21, 1953, requests the Board of Public Utility Commissioners to authorize it:

(a) to make, execute, and deliver to City Bank Farmers Trust Company, a third supplemental indenture, to be dated as of December 1, 1953, supplemental to its indenture dated as of April 1, 1937;

(b) to issue thereunder and sell, privately, to the purchasers named at the hearing, $1,200,000 principal amount of its first mortgage bonds, 4⅛ per cent series D, to be dated December 1, 1953 (except registered bonds, which are to be dated as provided in its original indenture), and to be due December 1, 1978, at a price equivalent to 100 per cent of their principal amount plus accrued interest to date of sale;

(c) to issue and sell, privately, to the purchasers named at the hearing, 9,000 shares of its $100 par value cumulative first preferred stock, 5¼ per cent series, total par value $900,000, at a price equivalent to their par value, plus accrued dividends to date of sale; and

(d) to issue 4 shares of its new common capital stock, having a par value of $25 per share, in exchange for each share of its presently outstanding common capital stock having a par value of $100 per share.

The proceeds from the proposed sale of securities are to be used:

1. To discharge 3½% promissory note dated November 2, 1953, due January 1, 1954	$800,000
2. To pay, in part, for the cost of permanent plant improvements, extensions, and additions made or to be made subsequent to September 30, 1953	1,052,000
3. To reimburse the applicant's treasury for the cost of permanent plant improvements, extensions and additions made subsequent to January 1, 1948, and prior to September 30, 1953, inclusive	248,000
Total	$2,100,000

The promissory note proposed to be discharged represents the latest renewal of prior notes, the proceeds of which were used for plant expenditures during the period from January 1, 1948, to September 30, 1953, inclusive.

[1] The applicant testified at the hearing that the purpose of the proposed four-for-one exchange of common stock is the assurance of continued control of the applicant's affairs by experienced management. Inasmuch as the applicant's preferred stock outstanding, and presently proposed to be issued, carries the same voting rights per share as the outstanding common stock on all corporate matters, it is implied that the applicant's desire to quadruple its voting rights under common stock arises from that fact. This quadrupling of the voting power of the holder of the common stock (Commonwealth Water & Light Company, the parent company) will assure continued control by the parent company. Without this exchange, a situation could develop, upon the issuance of a sufficient amount of additional preferred stock (with similar voting privileges), which would confer voting control upon the preferred stockholders as a class by virtue of their numerical holdings of shares. The purposes of the presently proposed four-for-one exchange of common stock appear to be reasonable and therefore can be approved.

[2] The debt capital ratio will be 63.9 per cent of total capitalization after the proposed transactions are completed. Under the board's policy the allowable maximum debt capital is usually not more than 60 per cent where there are three classes of securities. The board recognizes, however,

that the applicant's financial position is sound, and that its earning capacity is more than ample to cover the carrying charges on its debt, as well as the required dividends on its preferred stock. A considerable increase in the applicant's earning capacity is expected to result from the new construction presently planned and in progress. Plant additions, other than those covered in this application, will, of necessity, be financed from retained earnings and/or sales of common stock. The increase in equity capital resulting from such financing will gradually reduce the ratio of debt capital. In view of these circumstances, the issuance of the debt securities as proposed appears reasonable and therefore can be approved.

[3] The redemption provision contained in the form of the bonds proposed to be issued provides, inter alia, that none of the bonds shall be redeemable for refunding purposes until December 1, 1958, thus protecting the holders against any effectual reduction of the interest rate during the first five years. This appears reasonable and in the public interest in this case.

The redemption terms with respect to the proposed preferred stock provide, inter alia, that none of the preferred stock shall be redeemable for refunding purposes until December 1, 1958, thus protecting the holders against any effectual reduction of the dividend rate during the first five years. This appears reasonable and in the public interest in this case.

The board being satisfied after investigation and hearing, having considered the record and exhibits of the proceeding, that the said application should be approved, and approving the purposes thereof,

Hereby grants said application and authorizes the applicant (subject to Conference Order Number Seven):

(a) to make, execute, and deliver to City Bank Farmers Trust Company, a third supplemental indenture, to be dated as of December 1, 1953, supplemental to its indenture dated as of April 1, 1937;

(b) to issue thereunder and sell, privately, to the purchasers named at the hearing, $1,200,000 principal amount of its first mortgage bonds, 4⅛ per cent, series D, to be dated December 1, 1953 (except registered bonds, which are to be dated as provided in its original indenture), and to be due December 1, 1978, at 100 per cent of their principal amount plus accrued interest to date of sale;

(c) to issue and sell, pursuant to the terms of the preferred stock purchase agreement, presented at the hearing as Exhibit P–3, 9,000 shares of its $100 par value cumulative first preferred stock, 5¼ per cent series, total par value $900,000, to the purchasers named at the hearing, at a price equivalent to their par value, plus accrued dividends to date of sale; and

(d) to issue 4 shares of its new common capital stock, having a par value of $25 per share, in exchange for each share of its presently outstanding common capital stock having a par value of $100 per share.

This certificate is issued subject to the following provisions:

1. That the applicant shall not redeem at its option prior to maturity, except through operation of the Improvement Fund, any of the first mortgage bonds, 4⅛ per cent series D, with

or without coupons, due 1978, the issuance of which is hereby approved, without the approval of this board first applied for and obtained.

2. That prior to the redemption of any of these series D bonds through the operation of the Improvement Fund, the applicant shall give this board thirty days' notice, in writing, of each proposed redemption.

3. That the applicant shall not call for general redemption purposes, except through the operation of the sinking fund, any of the cumulative first preferred stock, 5¼ per cent series, the issuance of which is hereby approved, without the approval of this board first applied for and obtained.

4. That prior to the redemption of any of the cumulative first preferred stock, 5¼ per cent series, through the operation of the sinking fund, the applicant shall give this board thirty days' notice, in writing, of each proposed redemption.

5. That the applicant shall furnish to the board, within thirty days from the date of this certificate, proof of the cancellation of all, or substantially all, of its presently outstanding common capital stock certificates, which are to be exchanged for the new common capital stock, the issuance of which is hereby approved.

6. That this certificate shall not be construed as a certification that the securities proposed to be issued will be represented by tangible or intangible assets of commensurate value or investment cost.

7. That in any future application or proceeding, this certificate shall not affect or in anywise limit the exercise of the authority of this board, with respect to rates, franchises, services, capitalization, financing, accounting, or any other matters whatsoever affecting the applicant.

8. That this certificate shall become null and void and of no effect unless the authority herein granted is fully exercised within thirty days of the date hereof. This provision shall not apply with respect to such shares of the presently outstanding common stock which, after diligent effort, remain impracticable of cancellation.

The applicant shall file with the board, within fifteen days of the date hereof, a verified acceptance of this certificate and its provisions.

WISCONSIN PUBLIC SERVICE COMMISSION

Re Marquette-Adams Telephone Cooperative, Inc.

Re Community Telephone Company of Wisconsin

2-U-4062
October 16, 1953

JOINT *application by telephone company and co-operative for authority to discontinue unlimited interexchange service; granted.*

Service, § 462 — Unlimited interexchange telephone service — Abandonment.

1. A telephone company and a telephone co-operative were authorized to discontinue unlimited interexchange service where a substantial expenditure would be required for rehabilitation of circuits if the service were to continue and where, upon conversion of several of the exchanges to dial, it would be impractical to supervise the present optional flat-rate-toll traffic, p. 62.

Discrimination, § 157 — Telephone rates.

2. It is discriminatory to apply rates less than standard or to make no charge at all for a type of telephone service for which there is no general demand, since the costs of such service are absorbed in the general-exchange rate structure, p. 62.

By the COMMISSION: The joint application in this docket was filed on June 22, 1953. The Brooks, Oxford, and Packwaukee exchanges of the Marquette and Adams Telephone Cooperative are to be converted to automatic dial operation and the Westfield exchange of the Community Telephone Company will retain manual magneto service necessitating rearrangement of the present toll circuits and toll-rate structure upon cutover to dial service.

Hearing: On July 20, 1953, at Montello before examiner Samuel Bryan.

APPEARANCES: Henry Janke, General Manager, and Bruce Rogers, Attorney, Portage, for Marquette-Adams Telephone Cooperative, Inc.; Claude J. Jasper, Attorney, Madison, for Community Telephone Company. Of the commission staff: W. H. Evans, rates and research department.

[1, 2] The Westfield exchange of the Community Telephone Company is connected by a jointly owned circuit with the Oxford exchange of the Marquette-Adams Telephone Cooperative. The Westfield exchange is also connected by a jointly owned circuit with the Marquette-Adams Telephone Cooperative's Packwaukee exchange. The latter company's Brooks exchange is connected to Westfield via Oxford.

The Westfield exchange has 514 subscribers, the Oxford exchange 238, the Packwaukee exchange 75, and the Brooks exchange 52 subscribers. The air-line distance from Westfield to Oxford is 9 miles, from Westfield to Packwaukee 9 miles, and from Westfield to Brooks 9 miles.

The present toll-rate arrangement is a combination of unlimited service without toll charge, standard message rate tolls, and nonstandard message rate toll. Westfield makes no charge for messages to Oxford but applies standard toll rates to Packwaukee and Brooks. Oxford, Brooks, and Packwaukee apply standard toll rates and offer optional flat-rate toll to Westfield at a rate of 50 cents a month for each customer.

The companies contend that the present arrangement is discriminatory, that the expenditure of $5,600 for needed rehabilitation of present circuits is unwise, and that the conversion to dial of the Brooks, Oxford, and Packwaukee exchanges would make it impractical to supervise the optional flat-rate-toll traffic originating at the three Marquette and Adams Cooperative's exchanges.

A traffic study was made to determine the extent to which the service is used. An average of 4.3 per cent of Westfield subscribers made use of the unlimited toll service in a 7-day period, May 11th to 17th, inclusive. In a 7-day period from January 12th to 18th, inclusive, 9.6 per cent of the Brooks subscribers, 10.5 per cent of the Oxford subscribers, and 16.0 per cent of the Packwaukee subscribers made use of flat-rate-toll service.

The fact that relatively few subscribers make use of the present toll arrangement indicates that there is not a sufficiently close community of interest between the Westfield exchange and the *three* Marquette-Adams Cooperative's exchanges to warrant a departure from the standard-toll-rate structure. If there is not a general use of the service, then it follows that it would be discriminatory to apply rates less than standard or to make no charge at all as the costs are absorbed in the general-exchange rate structure. Also in view of the disclosed use of the service the expenditures necessary to rehabilitate the facilities in order to render nonstandard and optional flat-rate-toll service would be an unreasonable burden upon the general-exchange rate structure of both utilities.

The General Telephone Company has offered to furnish the circuits necessary to connect these exchanges to its area toll network which will provide alternate toll routes at no additional cost to the Community Telephone Company or the Marquette-Adams Telephone Cooperative, Inc. The service will be comparable to that provided by present facilities.

The commission finds:

1. That the present practice of the Community Telephone Company in offering unlimited interexchange service from its Westfield exchange to the Oxford exchange of the Marquette-Adams Telephone Cooperative, Inc., is unreasonable and unjustly discriminatory.

2. That the present practice of the Marquette-Adams Telephone Cooperative, Inc., in offering flat-rate toll for 50 cents a month from its Brooks, Oxford, and Packwaukee exchanges to

the Westfield exchange is unreasonable and unjustly discriminatory.

3. That the abandonment of present jointly owned toll facilities and the substitution therefor of facilities to be provided by the General Telephone Company will not impair the present service and is in the public interest.

The commission concludes:

That it has jurisdiction under §§ 196.03, 196.20, 196.37, 196.60, 196.62, and 196.81, Statutes, to enter an order herein and that such order should be issued.

Order

The commission therefore *orders:*

1. That the Community Telephone Company discontinue its present practice of offering unlimited interexchange service from its Westfield exchange to the Oxford exchange effective upon cutover to dial service of the Oxford exchange.

2. That the Marquette-Adams Telephone Cooperative, Inc., discontinue its present practice of offering flat-rate-toll service at 50 cents a month from its Brooks, Oxford, and Packwaukee exchanges to the Westfield exchange effective upon cutover of the Brooks, Oxford, and Packwaukee exchanges to dial service.

3. That the Community Telephone Company and the Marquette-Adams Telephone Cooperative, Inc., be and hereby are authorized to substitute the intrastate toll-rate schedule of the Wisconsin Telephone Company for toll messages between the Westfield and Brooks exchanges, Westfield and Oxford exchanges, and the Westfield and Packwaukee exchanges for the present toll rates where such toll-rate practices differ from the standard toll rates effective upon cutover to dial service of the Brooks, Oxford, and Packwaukee exchanges.

4. That the jointly owned toll circuits connecting the Westfield, Oxford, and Packwaukee exchanges be abandoned and interconnection be made to the toll facilities of the General Telephone Company's toll network for conveying toll messages between the Westfield exchange and the Brooks, Oxford, and Packwaukee exchanges of the Marquette-Adams Telephone Cooperative, Inc., effective upon cutover to dial service.

DELTA-STAR'S *New* "QB"

INTERRUPTING DEVICE FOR ALL AIR SWITCHES

VERTICAL, HORIZONTAL, HOOK STICK

For opening line charging currents, transformer magnetizing currents and small load currents at voltages from 15 KV to 161 KV.

Easily Installed on Switches Now in Service

Necessary phase spacings and clearances are not increased by the addition of the "QB" Device. The current path through a closed switch is through its main blade and contacts. The quick break blade is not in the current path until the switch starts to open; then the current is transferred from the main switch contact to the quick break blade.

Simple, Positive—No Additional Effort Required in Opening Switches When Frozen

The quick break blade is carried without extra effort. Ice on the main switch blade and contact is broken before effort is expended in breaking the ice on the "QB" attachment.

Spring and Current Carrying Members are Independent

Spring actuated quick break blade is mounted on the switch contact stack. This design permits the use of a more substantial construction, a heavy independent spring driving mechanism and much greater opening speeds.

"QB" Quick Break Device applied to a MK-40 Vertical Break Switch.

Fig. 1—Vertical Switch blade (A) is closed into the main contact (B) and the quick break blade (C) is in neutral position.

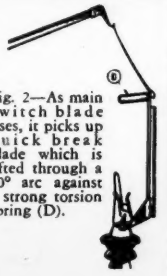

Fig. 2—As main switch blade rises, it picks up quick break blade which is lifted through a 90° arc against a strong torsion spring (D).

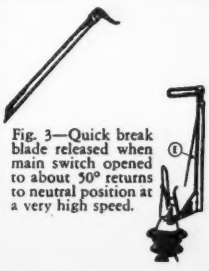

Fig. 3—Quick break blade released when main switch opened to about 30° returns to neutral position at a very high speed.

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Industrial Progress

eveland Electric Illum. Plans $63,000,000 Program

VELAND Electric Illuminating pany will spend $63,000,000 for truction and expansion of its ce facilities in 1954 and 1955, r L. Lindseth, president, an- ced in the company's annual re-

ese expenditures will raise the cost of the company's postwar nsion to $273,000,000, and are in with the growth of the district, e some $300,000,000 was ex- d for industrial installations last

,500,000 Program Proposed y Arizona Public Service

ZONA Public Service Company cts to spend a total of $25,500,000 ear to improve and expand serv-

luded in future plans is the new llo steam plant, which is ex- d to be built in the Phoenix area. company is presently building a 00 kilowatt plant at Red Rock. irst 100,000 kw unit of this plant heduled for service about mid-

4 MC Mobile Radio System Announced by Du Mont

first two-way mobile radio pment designed and developed by B. Du Mont Laboratories, Inc. een announced by the Mobile nunications Department of the ny. This first complete Du system is for operation in the mc band and provides a com- rugged unit with minimum pow- quirements.

ording to the company, the field ing requirements of public es, mobile police communica- forestry and logging services, petroleum industries, and trucking fleets, have been carefully considered in this initial design. Other equipment is under development for the 150-160 mc band and for 450-470 mc.

Complete information on the Du Mont Type MCA-101A Mobile System is available upon request from the Mobile Communications Department, Allen B. Du Mont Laboratories, Inc., Clifton, N. J.

New Receiptor Announced by American Perforator

A NEW, fast action, electric, stamping receiptor, the Model 200, for receipting public utility bills or postcards, has been announced by The American Perforator Company, Chicago.

The new receiptor is designed to be especially useful to gas, light, water, telephone, insurance companies, currency exchanges or wherever bills are receipted. It stamps bills "Paid," the teller's identification number and the date and severs the bill and automatically drops the accounting stub in a locked compartment for safe keeping.

The stamp does not cut or notch holes in the paper, thereby making no alterations that would cause mis-sorting or jam any electronic sorting or tabulating machine. Among the other features claimed are: A continuous ribbon which eliminates changing spools or the need for inking pads; a standard hand changing ratchet type date mechanism which allows fast clean changing of dates; and no type to set because all printing is done with engraved plates, thus assuring satisfactory impressions at all times.

The American Receiptor is portable, measuring 12 in. x 8 in. and weighing only 16 pounds. Its finish is designed to blend well with the color scheme of any office.

Model 200 is the product of countless surveys conducted by The American Perforator Company for a machine that would incorporate all of the features wanted most by Utilities, municipalities, currency exchanges and other offices where collections are made.

The American Perforator Company are the originators of portable receipting perforators which have been popular in utility offices for many years.

Indianapolis Pwr. & Lt. to Spend $42,000,000 on 4-Year Program

INDIANAPOLIS Power and Light Company recently announced a four-year construction program, costing more than $42,000,000. This will make a total of almost $132,000,000 for enlarging and improving the system in the period from 1946 through 1957.

Included in the immediate program is a $14,600,000 addition to the White River power plant near Centerton. This 105,000-kilowatt generating unit, sixth at that plant and largest in the system, is scheduled for completion by the end of 1955.

New Earth Boring Machine Offered by Multi-Matic

A NEW model Super Hole-A-Matic, one-man operated earth boring and tunneling machine that will dig holes up to 12 inches in diameter, 15 feet deep, has been developed by Multi-Matic Corporation. A complete machine, the Super Hole-A-Matic is lightweight, portable, and is said to cost far less than similar equipment for planting telephone poles, guy wires, concrete pier holes or soil testing.

Further information may be obtained from the manufacturer, 14741 Bessemer street, Van Nuys, California.

(*Continued on page* 28)

Ohio Power to Spend $37,500,000 in 1954

DURING 1954, The Ohio Power Company will invest approximately $37,500,000 to improve and enlarge facilities for the generation, transmission and distribution of electric power to its more than 395,000 customers.

The new budget includes funds to complete the new 400,000-kilowatt Muskingum river plant; to start construction of the revolutionary ultra-high pressure and temperature unit at Philo plant; to improve coal-handling equipment at Philip Sporn plant; to enlarge and continue construction of a 330,000 volt transmission line across Ohio and to erect many new transmission and distribution lines and substations.

In general categories, the new budget is set up as follows: Power Plants, $12,000,000; Transmission lines, $6,400,000; Distribution lines, $7,700,000; Transmission subs, $7,000,000; Distribution subs, $1,800,000; Coal lands, equipment, $300,000; and General, $2,300,000.

New All-purpose Digger

THE Acker Drill Company, Inc., of Scranton, Pennsylvania, presents a new, medium size, all-purpose digger.

The Acker digger is claimed to be ideal for speedy digging of holes for setting telephone and electric line poles, fencing and guard rails, for foundation work, tree planting, cathodic protection of pipe lines, and other earth digging requirements. With a standard spiral auger head, the digger can bore holes up to 20 in. in diameter and to depths of 10 feet. By using sectional continuous flight augers, depths up to 75 feet can be reached. A special pavement test core attachment for cutting reinforced concrete is available.

A new bulletin describing this new digger is available from the manufacturer. Write for Bulletin 40.

$62,039,000 Program Planned By South Carolina Elec. & Gas

SOUTH Carolina Electric and Gas Company, and subsidiaries, estimate that construction expenditures for the years 1954-1956, inclusive, will amount to $62,039,000. The 1954 program will account for $18,774,000 of this sum.

New Primer Stops Rust Action

A PRODUCT known as OSPHO has been developed by Rusticide Products Company, Cleveland, O. OSPHO is a metal primer, not a paint, that is applied directly over rust and stops rust action, according to the manufacturer.

The company claims there are definite savings in time and application time when OSPHO is used as it is not necessary to remove tight rust, since OSPHO is applied directly over rust either by brush or spray method; furthermore, that paint jobs last two to three times longer. According to the manufacturer, OSPHO is being used in larger quantities to many public utilities, chemical and petroleum plants, industrial concerns, and municipalities, where rust has always been a real problem.

Ford, Bacon & Davis Celebrates Sixtieth Anniversary

ONE of the country's oldest engineering and construction organizations is Ford, Bacon & Davis of New York, Chicago, Los Angeles, Toronto, and Monroe, La. Established in March 1894, the firm has completed 60 years of continuous service.

Conversion of horse- and mule-drawn trolley to electrified systems was the firm's principal work in its early days. Electric public utility systems were also designed and built. Activities were widened as a result of the First World War, when the government and industry called upon the organization to design and construct port facilities, warehouses, shipyards, munitions and industrial plants.

Natural gas attracted the firm's interest in the cities, and it pioneered the development, design, and construction of some of the earliest long-distance, large-diameter pipe lines.

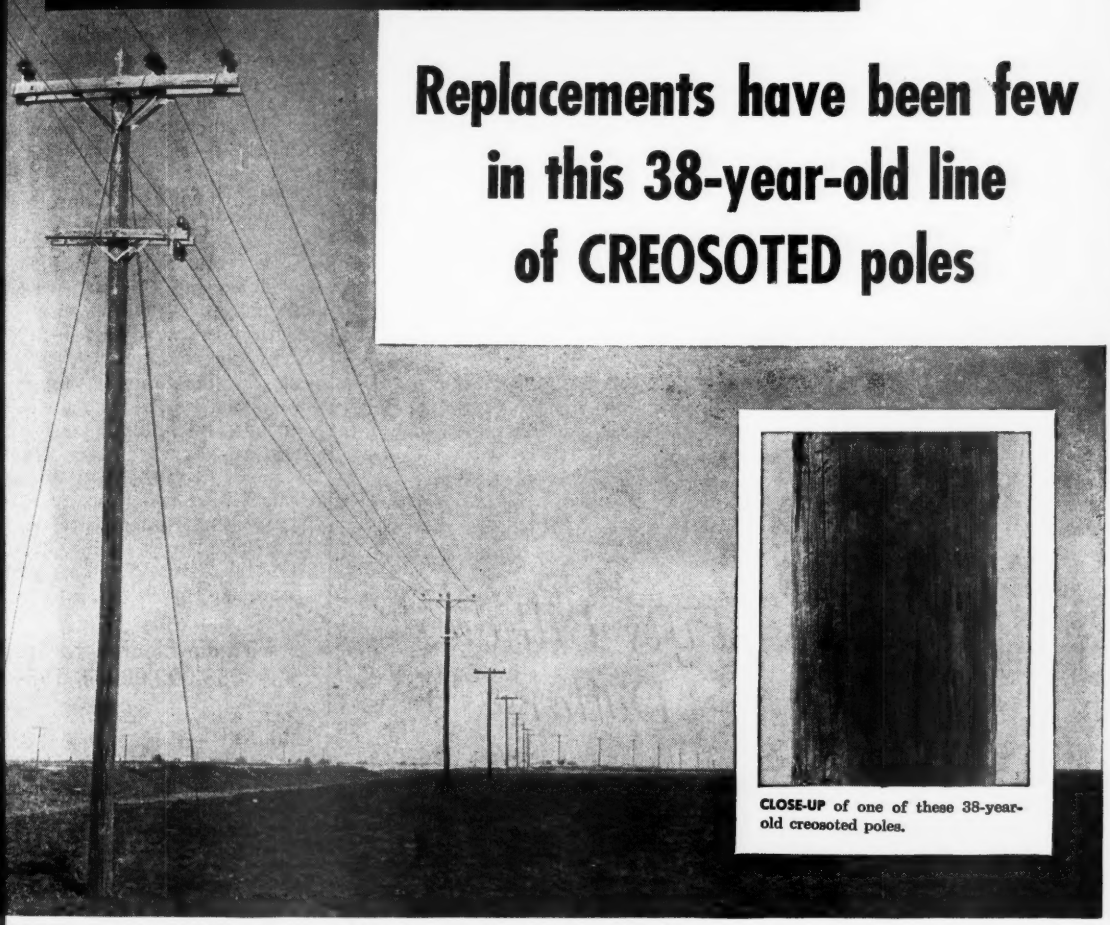
World War II saw Ford, Bacon & Davis designing and constructing large-scale plants to produce synthetic rubber, aircraft engines, submarines, an airbase in Bermuda, port and terminal facilities for crude oil, power plants and part of the Manhattan Project at Oak Ridge.

In the postwar period, principal projects have included, among others, power plants for industrial and public utility companies, natural gas pipe line systems and facilities for the underground storage of natural gas.

In addition to design and construction, the firm conducts a diversified consulting engineering practice covering technical and economic reports for financing, valuations of properties and equities, industrial engineering, organization studies, market surveys, public utility rate cases and reports for management on specific problems or the over-all aspects of the business.

Here's Proof of Performance...

Replacements have been few in this 38-year-old line of CREOSOTED poles



CLOSE-UP of one of these 38-year-old creosoted poles.

MERTENS-TO-MALONE LINE of Texas Power and Light Company, 94% of the Creosoted poles set in 1916 are still in service.

...s Power and Light Company ...s had excellent performance ...poles treated with Creosote on ...locations in its far-flung sys... For example, the long life in ...ction between Mertens and ...e is outstanding.

...916, 196 Southern Yellow Pine ... treated with Creosote, re... untreated poles that had ...ess than 15 years' service. To ...nly about six per cent of these ...ave been replaced, and most of the replaced poles were casualties from reasons other than decay.

Texas Power and Light Company feels that there are at least 10 years of life left in the remaining poles, and when they are replaced, poles treated with Creosote will be used again.

Creosote's combination of toxicity and permanence is the reason why it has established so many service records like this. And service records, after all, are your best assurance of future performance from a wood preservative.

You can take an additional step toward finest performance by specifying USS Creosote. USS Creosote is the uniform product of continuous tar processing in the plants of United States Steel. For further information, contact our nearest Coal Chemical sales office or write to United States Steel Corporation, 525 William Penn Place, Pittsburgh 30, Pennsylvania.

USS CREOSOTE

USS

UNITED STATES STEEL

INDUSTRIAL PROGRESS
(Continued)

Middle South Utilities Syste To Spend $65,000,000

MIDDLE South Utilities Sy companies will spend $65,000,0 1954 on new construction, it is nounced by E. H. Dixon, presi in the annual report to stockholde

This would bring total system ital expenditures for the nine period 1946-54 to $468,000,000.

Heath Survey Consultant Elect Officers

AT a recent annual meeting o stockholders of Heath Survey sultants, Inc., the following of and directors were elected: Milto Heath, president and general ager; Mrs. Elizabeth W. Heath, urer; Charles A. Heath, vice dent and operations manager o Western division; Mrs. Rosi Burnham, assistant to the presi Stuart B. Eynon, operations ager of the Eastern division. D tors elected were Milton W. H Mrs. Elizabeth W. Heath, Dav Place and Robert S. Kittredge.

Virginia Electric to Spen $53,000,000 in 1954

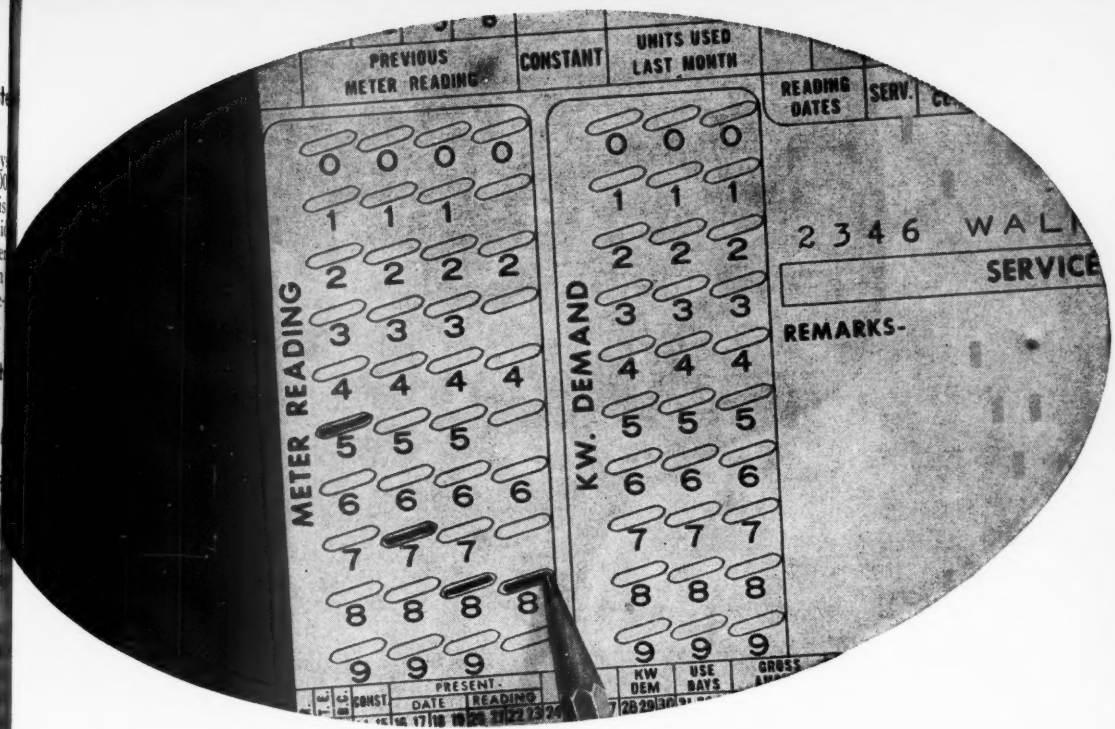
THE Virginia Electric and P Company will spend about $5 000 on construction during 19 more than a million dollars a according to Jack G. Holtzclaw, co president. The 1954 constr budget represents an increase o 000,000 over 1953.

Approximately $27,000,000 total budget is earmarked for power generating facilities; $1 000 for work on the hydro de ment at Roanoke Rapids, N. C 454,000 to complete the secon 000 kilowatt generating unit and fuel oil system now under con tion at the Portsmouth, Vi power station, and $6,146,80 third unit now under construc the Possum Point power statio Quantico, Virginia, for comple 1955.

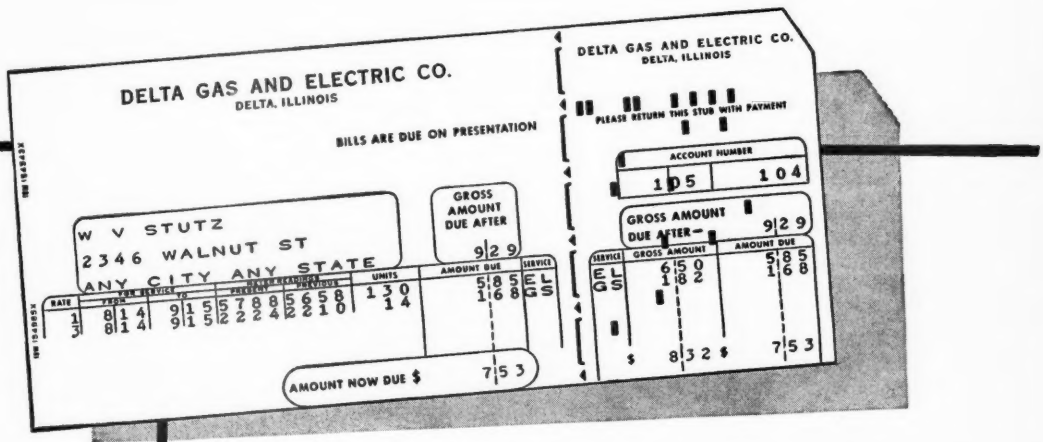
Extensions and changes company's transmission line n over the system will amount t than $5,000,000 dollars.

Improvements to the electri tribution system and for com new customers will cost $18,0 Included in the appropriation 050,000 for building 431 miles rural lines throughout the com service area comprising most

(Continued on page 3



THESE MARKS CUT COSTS



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INDUSTRIAL PROGRESS
(Continued)

State of Virginia, part of West ginia and Northeastern North lina.

During the past six years, ac ing to Mr. Holtzclaw, Vepc spent $219,000,000 on constr and it is estimated that in the c five years, another $200,000,00 be needed for new generating p transmission lines and other fac

$7,600,000 Program Propo By Idaho Power

IDAHO Power Company spen 202,372 in 1953 for expansio improvement to plant.

The construction budget fo year has been set at $7,600,00 including an undetermined amou new generating facilities.

Gen. Tel. of Cal. Installs 7 New Phones in Two Mon

GENERAL Telephone Comp California added more than 7,5 telephones to its system duri first two months of 1954, acc to Edwin M. Blakeslee, pre The company had 584,509 tele in service on February 28th year compared with last year's of 529,734 taken the same da 54,775 gain represents an incr telephones of better than 1 twelve months.

The company is in its third of a $41,000,000 construction gram in 1954 to increase and i facilities in the 90 California munities served.

Hydraulic Goosenecking Available on Pitman Cr

A HYDRAULICALLY op goosenecking boom is now a as an optional accessory on th man Crane, Model 80, 4-ton crane manufactured by Pitman Company, Kansas City, Mo.

This boom, believed to be th of its type ever offered comme was developed by Pitman as a easy solution to overhead trave ance problems.

The Pitman Crane is desig that a trailer can be pulled same truck the crane is mount crane can be used to load direct and off of this trailer. With th gooseneck-type boom, the o can fold the boom down over a trailer simply by pushing a le his regular operating station ready for road travel in a ma seconds. Pitman officials asse

(Continued on page 33)

odel 80 with its gooseneck boom enable utility companies and s to drastically reduce equip- and man-power costs of handling auling pipe, poles, steel and many types of materials.

ll details may be obtained from n Manufacturing Company, 300 79th Terrace, Kansas City 14, uri.

k Becomes Chief Engineer American Meter

DING V. BECK has been ap- ed chief engineer for the Ameri- Meter Company, Inc., manufac- of gas meters, regulators and uments at 10 factories throughout United States and Canada, ac- ing to an announcement made by m G. Hamilton, Jr., president. Beck will direct all engineering ties for the company and will ain his headquarters at the offices of the Erie Factory lo- at 921 Payne avenue.

sher Courses Offered Gas Utility Employees at IIT

R college courses designed as hers for utility gas industry em- es will be offered at the Institute s Technology, an affiliate of Il- Institute of Technology, Chi- during the summer session.

e four subjects are: Natural Gas 14-July 2); Transmission and bution (July 6-23); Peak and Load Natural Gas Substitutes 26-August 3), and Utilization seous Fuels (August 16-Sept.

t. E. S. Pettyjohn, director of s institute, explained that the es are at college senior level and e taken for academic credit by ed undergraduates. Others will arded certificates upon success- ompletion. Any or all of the es may be taken by enrollees.

e subjects will be taught at the ute of Gas Technology on the is Tech campus, and IIT housing e available for students.

eece-Neville Offers New 3-Phase Transformer

Leece-Neville Company, Cleve- has developed a three-phase former which makes it possible tain up to 1200 watts of aux- 110 volt d.c. power to operate nd appliances in automotive ve- equipped with the Leece-Neville Alternator system in place of conventional d.c. generators.

The new transformer takes full advantage of the high power output of the alternator for such purposes as operating 5/8 in. electric drills, small chain saws, pneumatic tools, electric blankets, artificial respirators, traffic signals, flood lights, etc., direct from a utility truck.

Unlike the presently available 250 watt 110 v. a.c. transformer (which delivers a frequency equal to 1/10th alternator r.p.m.), the new unit's output is independent of motor speed.

The new transformer (along with a companion 110 v. selenium rectifier) is operated in parallel with the standard rectifier and voltage regulator, leaving undisturbed operation of the alternator for its primary purpose, that of supplying 6 v. d.c. power for high-efficiency battery charging and vehicle operation.

Two models of the new transformer are available: for 6 volt systems, the 1013-T unit is rated at 800 watts; for 12 volt systems, the 1012-T unit has an output of 1200 watts.

Norberg Appointment

APPOINTMENT of Richard H. "Dick" McCarthy as sales engineer, is announced by R. W. Bayerlein, vice president, Heavy Machinery Division, Nordberg Manufacturing Company, Milwaukee 1, Wisconsin.

Mr. McCarthy will headquarter at Nordberg's branch office, 419 Cotton Exchange building, Dallas 1, Texas, serving large, heavy duty engine users in North and Central Texas, Oklahoma, and New Mexico.

New Unit-Supported Bus Announced by G-E

A NEW unit-supported bus of the isolated phase design, capable of withstanding the high short circuit currents of modern power systems and having a margin for future system growth, has been announced by the General Electric Company's High Voltage Switchgear Department, Philadelphia, Pa. The bus is generally used for direct connection of generators and main power transformers in a unit generation system.

Weighing 13½ per cent less than present typical three-phase sections and having single insulator supports, the equipment allows easier installation and maintenance than previous bus designs, according to G-E engineers. They said the single supports reduce the possibility of insulation failure.

The new bus is available in lengths of three phase sections up to 16 feet and ratings up to 10,000 amps, 14.4 to 34.5 kv.

No. Indiana Public Serv. to Spend $49,000,000 in 2-year Program

NORTHERN Indiana Public Service Company will spend $49,000,000 for expansion and modernization during the next two years, Dean H. Mitchell, president, announced recently in the company's annual report to stockholders.

Mr. Mitchell said the expansion program was being undertaken to supply the continually increasing demands of customers and to keep pace with the rapid development of the communities they serve.

The company estimates that $22,500,000 will be spent for new construction in 1954 and the remaining $26,500,000 in 1955.

The two year program includes $11,000,000 for an electric production plant, $9,000,000 for electric transmission property, $5,000,000 for electric distribution facilities, $9,000,000 for service to new electric and gas customers, $8,000,000 for gas distribution facilities, and $7,000,000 for buildings, automotive and general equipment.

Southern Cal. Gas Plans $30,446,303 Program

SOUTHERN California Gas Company has set up a budget for 1954 that totals $30,446,303, it was announced recently by President F. M. Banks. This will be the eighth consecutive year since the end of World War II that the company's annual investment has exceeded $25,000,000.

According to the announcement, the major portion of the money this year is needed (1) to bring service to new customers being added to the system at a rate well in excess of 50,000 a year; (2) to replace worn out pipelines and to reinforce the pipeline system in a distribution replacement program; and (3) to support a program for plant and property replacements and additions.

About $10,000,000 of the total annual budget for 1954 will be used for new service connections, the company estimates, and an additional $1,500,000 will be expended on pipelines and facilities to expand the gas supply system.

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of Feature Articles in

PUBLIC UTILITIES FORTNIGHTLY

Reprints of feature articles in recent issues of PUBLIC UTILITIES FORTNIGHTLY are listed here as a special service.

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by Holgar J. Johnson, September 10, 1953

Justice for Utility Holding Company Equities
by Frank D. Chutter, October 8, 1953

The District Manager—Unsung Hero
by Harold H. Young, October 22, 1953

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Explaining the Rate Case to the Employee
by James F. Oates, Jr., November 5, 1953

Roadblocks to Sound Utility Regulation
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I Am a Utility Bus Driver
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The Impact of Changing Price Levels on Rate Making
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Beating New England Weather
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Seventy-five Years of Electric Light
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60,000 KW's in a Dance Chamber...

gend has it that the crew of the historic "Half oon" was so terrified by the nighttime spec-cle of Indians dancing about a fire on a great rock jutting out into the Hudson River that cy exclaimed, "De Duyfels Dans Kammer!" he Devil's Dance Chamber!

Today this same jut, a few miles north of wburgh, N. Y., supports a more enlightening ectacle. It is the site of a unique power plant, t of the 60,000-kw series of condenser-ounted units designed by Burns and Roe, Inc. engineers. Known as Danskammer Point eam Station, it will soon have a second 60,000-unit of similar design. Ultimately the station ill provide far greater capacity.

This plant is the first major steam station for entral Hudson Gas & Electric Corporation. The mpany's other sources of power are largely ydro-electric facilities and interconnections ith other utilities.

Kellogg, having furnished and erected piping for the first unit, is currently installing the high-temperature, high-pressure main steam and reheat piping for the second turbine-generator in this station, a structure which is remarkable for its compactness and low investment cost. The building volume is about 14.5% less than that of a conventional enclosed plant of the same capacity, mainly the result of mounting the turbine directly on the condenser thereby cutting down the height of the basement.

In its close association with progressive power companies such as Central Hudson and leading engineers like Burns and Roe, Kellogg has continually made important contributions to major developments similar to the Danskammer station. Its recognized technological background is one of the basic reasons why utilities time and again specify "... *critical power piping by Kellogg.*"

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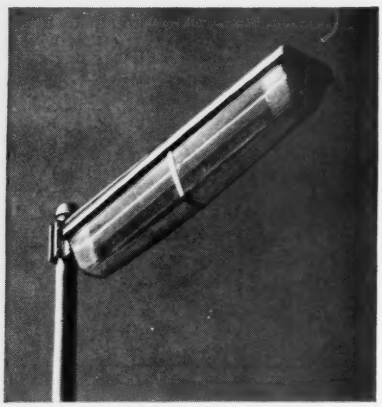
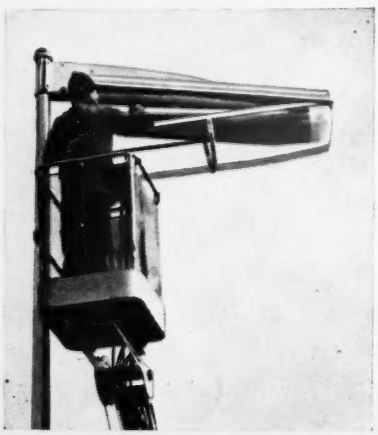


MODERN APPEARANCE of new fluorescent luminaires adds beauty to city streets. Design also helps eliminate glare.



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Every installation of General Electric's new fluorescent street lighting has been enthusiastically received by local citizens, businessmen, and civic officials. They appreciate the outstanding nighttime visibility provided by fluorescents, and the modern up-to-date appearance these functionally designed luminaires bring to their streets.

BETTER VISIBILITY—You see better on a street lighted with new G-E fluorescent luminaires for several reasons. The whiter color of the fluorescent lamps has a crisp, sparkling character all its own. Because the light source is so much larger than with mercury or filament lamps, the brightness over the area of the luminaire is lower—even though lumen output is comparable. This means less glare to interfere with visibility. There is also a much broader area of pavement brightness from this larger light source which improves visibility on dry or wet pavements.

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